# I. ELECTION YEAR ISSUES

**by**
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## 1. Introduction

In a presidential election year, many exempt organizations become more active in what has been loosely termed "political activity". Some exempt organizations use this opportunity to encourage people to participate in the electoral process. Others increase their advocacy activity to take advantage of the heightened awareness given to many issues during the course of a campaign. This advocacy activity may be to raise public awareness of particular issues, to influence the passage of legislation concerning particular issues (lobbying), or to elect candidates based upon their position on particular issues (electioneering). The Internal Revenue Code distinguishes between these types of activities, potentially resulting in differing tax consequences. This article focuses on the federal tax rules applicable to exempt organizations concerning electioneering activities.[1]

Questions frequently arise regarding the interplay of political campaign activities and exemption from federal income tax. This article addresses many of these questions in three areas: the prohibition on political campaign activities of IRC 501(c)(3) organizations, the taxation of political organizations under IRC 527, and the political campaign activities of IRC 501(c) organizations other than those described in IRC 501(c)(3).

Much has happened since the publication of this article's predecessor, "Election Year Issues," in the Exempt Organizations Continuing Professional Education Technical Instruction Program for Fiscal Year 1993 (hereinafter 1993 CPE Text). A development of singular importance occurred on July 1, 2000, when President Clinton signed Public Law 106-230, which amends the treatment of political organizations under IRC 527. The new law, which became effective immediately, imposes three different reporting and disclosure requirements on IRC 527 organizations: (1) an initial notice, (2) periodic reports on contributors and expenditures, and (3) modified annual returns. Included in this article is a description of the provisions of Public Law 106-230 and the steps that the Service is taking to implement the law.

This article also takes into consideration comments that were generated by the 1993 CPE Text. Of particular importance has been the "Commentary on IRS 1993 Exempt Organizations Continuing Professional Education Technical Instruction Program Article on 'Election Year Issues,' prepared by individual members of the Subcommittee on Political and Lobbying Activities and Organizations of the Committee on Exempt Organizations of the Section on Taxation, American Bar Association" (Feb. 21, 1995), reprinted in 11 Exempt Organization Tax Review 854 (Apr. 1995),

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[1] For an overview of the federal tax rules concerning political and lobbying activities by exempt organizations, see "Appendix B: Present-Law Rules Governing Political and Lobbying Activities of Tax-exempt Organizations," Staff of the Joint Committee on Taxation, 106th Cong. 2nd Sess., Report of Investigation of Allegations Relating to Internal Revenue Service Handling of Tax-Exempt Organization Matters 122 (Joint Comm. Print 2000)(hereinafter 2000 Joint Committee Report). For a detailed description of the federal tax rules applicable to lobbying activities of exempt organizations, see "Lobbying Issues," Exempt Organizations Continuing Professional Education Technical Instruction Program for Fiscal Year 1997 (hereinafter 1997 CPE Text).

(hereinafter 1995 ABA Comments). Where we have agreed with the 1995 ABA Comments and, where feasible, we have used such comments to update or modify treatment of issues in the 1993 CPE Text. However, some issues mentioned and positions proposed in the 1995 ABA Comments are not discussed here because of the nature of this article. This article is a training document and, as the introduction to all of the Exempt Organization CPE texts states: "The text is for educational use only. It is not authority, and may not be cited as such. It may be used as a research tool, but not as a substitute for analysis and research of citable legal authority." Consequently, where, as in some instances, the 1995 ABA Comments request additional guidance, the Service can be responsive only in a precedential document, and this article is not a document of that type.

Like the 1993 CPE Text, this article employs a question and answer format. A listing of the subjects appears at the end of this article. A word of warning, though -- many questions, particularly respecting IRC 501(c)(3) organizations and the political campaign prohibition, do not admit of a bright-line answer. In these areas, the facts and circumstances of a particular situation will control; therefore, some "answers" will instead consist of a description of the factors to be evaluated in reaching a determination.

## 2. IRC 501(c)(3) Organizations and the Political Campaign Prohibition

### A. History of the Statutes

#### (1) Enactment of the Prohibition

Prior to 1954, there was no statutory provision absolutely prohibiting organizations described in the antecedents of IRC 501(c)(3) from engaging in political campaign activities.[2] The political campaign prohibition does have a vague and unenacted antecedent, however. What eventually became the Revenue Act of 1934, under which the lobbying restriction of IRC 501(c)(3) was first enacted, at one time contained a provision extending the prohibition to "participation in partisan politics." S. Rep. No. 73-558, 73d Cong., 2d Sess. 26 (1934). The provision, however, was deleted in conference, so that only the lobbying restriction remained. H.R. Conf. Rep. No. 73-1385, 73d Cong., 2d Sess. 3-4 (1934). In explaining its deletion, Representative Samuel B. Hill stated: "We were afraid this provision was too broad." 78 Cong. Rec. 7,831 (1934).

During Senate consideration of what became the Revenue Act of 1954, Lyndon Johnson, then Senate Minority Leader, added a floor amendment to provide that IRC 501(c)(3) organizations may not "participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of any candidate for public office." Johnson stated ". . . [t]his amendment seeks to extend the provisions of section 501 of the House bill, denying tax-exempt status to not only those people who influence legislation but also to those who intervene in any

[2] For a discussion of the common law treatment of charities and political activity, see Debra Morris, "Political Activity and Charitable Status at Common Law: In Search of Certainty," in Political Activities: Nonprofit Speech, New York University School of Law National Center on Philanthropy and the Law Conference (1998) reprinted in 23 Exempt Organization Tax Review, 247 (Feb. 1999).

political campaign on behalf of any candidate for public office." 100 Cong. Rec. 9,604 (1954). The amendment was accepted; no debate or discussion took place. The Conference Report (H.R. Conf. Rep. No. 83-2543, 83d Cong., 2d Sess. (1954)) contains no further discussion of the amendment.

There is an obvious disconnect between the language of the provision and the stated intent of its author. The 1954 amendment prohibits political campaign activities by IRC 501(c)(3) organizations while the provision to which it is analogized only restricts attempts to influence legislation by those organizations. This is a knot no one has been able, or even attempted, to untangle.[3]

(2) Private Foundations and Electioneering Activities

In 1969, a number of provisions were enacted concerning the treatment of private foundations. Under one provision, an initial tax in an amount equal to 10 percent of each taxable expenditure and an additional 100 percent tax on each taxable expenditure previously taxed and not corrected within the taxable period is imposed on the private foundation. In addition, taxes are imposed on foundation managers who agreed to the making of the taxable expenditure. IRC 4945. A taxable expenditure includes any amount paid or incurred by a private foundation to influence the outcome of any specific public election or to directly or indirectly carry on any voter registration drives, unless certain requirements are met. IRC 4945(d)(2).

Thus, due to the Tax Reform Act of 1969, a private foundation that participates in a political campaign not only risks losing its exemption, it also is subject to tax on the amounts it expends for such participation. Taxes on private foundation expenditures to influence the outcome of any specific public election or to carry on voter registration drives did not seem likely when the House Committee on Ways and Means began its hearings on private foundation activities -- the Chairman's press release, which outlined the hearings' agenda, made no mention of this kind of activity. Tax Reform 1969: Hearings Before the House Comm. on Ways and Means, 91st Cong., 1st Sess. 3-11 (1969) (press release of Chairman Wilbur D. Mills). However, testimony given almost at the outset of the hearings raised the specter of private foundation involvement in the electoral process. First, in a rather scathing manner, an incumbent congressman testified that a private foundation had been used against him in a primary election. Id. at 213-237 (statement and testimony of Representative John J. Rooney).[4] Soon thereafter, the President of the Ford Foundation became embroiled in a lengthy and often acrimonious discussion with various Committee members over both the

[3] Hypotheses as to why Johnson proposed enactment of the prohibition are discussed in Appendix I.

[4] Subsequent to Representative Rooney's testimony, his primary opponent (and, oddly enough, eventual successor in Congress) appeared before the committee and denied all of Rooney's allegations. Id. at 1036-1056 (statement and testimony of Frederick W. Richmond). Wherever the truth lay, however, was not critical -- Rooney's words, ". . . this political gimmick is a threat to every officeholder, in Congress or elsewhere, who does not have access to a fat bankroll or to a business or to a private foundation" (id. at 213), spoke to what could happen, whether or not it actually occurred in the particular case. The potential effect of Rooney's testimony was made manifest when the columnist Kenneth R. Crawford devoted an entire article to the matter, predicting correctly that "[t]he tax reform bill almost certainly will impose tighter restrictions on tax-exempt foundations, especially against political activity." "The Rooney Reform," Newsweek, Mar. 3, 1969, at 29.

Foundation's involvement in an extremely controversial school decentralization experiment in Brooklyn that included an election and the Foundation's financing of voter registration drives in Cleveland before the election of Mayor Carl B. Stokes. Id. at 354-431 (statement and testimony of McGeorge Bundy). To a considerable extent, those incidents seem to have impelled enactment of IRC 4945(d)(2).

(3) Enactment of Additional Provisions

In 1987, Congress again amended the law applicable to charitable organizations, this time specifically focusing on the prohibition on political campaign activity. Congressional concern appears to have been triggered by two occurrences. First, in 1986, an organization then exempt under IRC 501(c)(3), the National Endowment for the Preservation of Liberty, was reported to have intervened in Congressional campaigns, opposing the reelection of members who had not supported aid to the Nicaraguan Contras. Second, questions had been raised about the use of ostensibly educational IRC 501(c)(3) organizations by politicians to promote their candidacy or potential candidacy. After hearings held by the Subcommittee on Oversight of the Committee on Ways and Means and after the Subcommittee made its recommendations, IRC 501(c)(3) was amended to clarify that the prohibition on political campaign activity applied to activities in opposition to, as well as on behalf of, any candidate for public office, in accordance with the existing interpretation of the prohibition in the regulations.

Congress also amended IRC 504 to provide that an IRC 501(c)(3) organization that lost its exemption due to violating the prohibition on political campaign activities may not at any time thereafter be treated as an IRC 501(c)(4) organization. (Previous to the amendment, IRC 504 had applied only to IRC 501(c)(3) organizations that lost their exemption due to substantial lobbying activities.)

In addition to these amendments, Congress enacted several new provisions in 1987 concerning the political campaign prohibition for IRC 501(c)(3) organizations. The first of these was IRC 4955, which imposes taxes on the political expenditures of IRC 501(c)(3) organizations; its tax/correction structure and the rates imposed are identical to IRC 4945. As set forth in the legislative history, Congress enacted IRC 4955 because it believed that the absence of any stricture other than revocation for violation of the prohibition on political campaign activity created two problems. One was that the penalty of revocation was disproportionate to the violation in cases where the expenditure was small, the violation was unintentional, and the organization subsequently had adopted procedures to assure that similar expenditures would not be made in the future. The other was that, in some cases, revocation would be an ineffective remedy, particularly if the IRC 501(c)(3) organization ceased operations after it diverted all of its assets to improper purposes. Therefore, IRC 4955 applies to IRC 501(c)(3) organizations whether or not their tax-exempt status is revoked. Congress specifically noted that the enactment of IRC 4955 did not change the prohibition on political campaign activities of IRC 501(c)(3) organizations; it looked upon the provision fundamentally as an additional deterrent. In addition, because Congress was concerned that some candidates were using IRC 501(c)(3) organizations to promote their candidacy, it provided that, for purposes of IRC 4955, political expenditures of IRC 501(c)(3) organizations include certain

expenses of candidate-controlled organizations. H.R. Rep. No. 100-391, 100th Cong., 1st Sess. 1623-1627 (1987).

Congress also found that existing audit and enforcement procedures were not sufficient to deter an IRC 501(c)(3) organization from flagrantly violating the political campaign prohibition. Therefore, it enacted IRC 6852 and IRC 7409. IRC 6852 provides that if such a violation occurs, the Service may immediately determine the amount of income and IRC 4955 tax due from the IRC 501(c)(3) organization. IRC 7409 grants authority to the Service to seek an injunction against an IRC 501(c)(3) organization that flagrantly violates the political campaign prohibition to prevent further political expenditures by the organization.

B. General Issues

**1. What is the political campaign prohibition?**

An organization will not qualify for tax exemption under IRC 501(c)(3) unless it "does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of (or in opposition to) any candidate for public office."[5] A determination whether an organization has participated or intervened is based upon all of the relevant facts and circumstances.

**2. What is a "candidate for public office?"**

Reg. 1.501(c)(3)-1(c)(3)(iii) and Reg. 53.4945-3(a)(2) both limit the meaning of the term "candidate for public office" to an individual who offers himself, or is proposed by others, as a contestant for an elective public office, whether such office be national, state, or local. Since a candidate must be a contestant for elective public office, IRC 501(c)(3) organizations are prohibited from participating or intervening in election campaigns only. Thus, an IRC 501(c)(3) organization is not prohibited from attempting to influence the Senate confirmation of an individual nominated by the President to serve as federal judge since federal judges are not elected. Notice 88-76, 1988-2 C.B. 392.

**3. What is a "public office?"**

Neither the IRC 501(c)(3), the IRC 4945 nor the IRC 4955 regulations define the term "public office." Nevertheless, there are criteria available, all of which proceed from the obvious principle that the term "public office" requires that there be some statutory or constitutional basis for construing the office as "public." For example,

[5] This article focuses only on the political campaign prohibition. To qualify as an organization described in IRC 501(c)(3), the organization must also meet the other requirements of IRC 501(c)(3), including the requirements that it be organized and operated for an exempt purpose, that there be no inurement and that it be operated for the public rather than private benefit. For a discussion of cases involving private benefit issues, see Appendix II.

guidance on the issue of whether an office or position in a political party is a public office for purposes of the IRC 501(c)(3) political campaign prohibition is found in G.C.M. 39811 (June 30, 1989). The particular position at issue in the G.C.M. was that of precinct committeeman. The position possessed the following characteristics of a public office under state law: it was (1) created by statute; (2) continuing; (3) not occasional or contractual; and it (4) had a fixed term of office; and (5) required an oath of office. G.C.M. 39811 concludes that, under the relevant state law, the position of precinct committeeman was a public office within the meaning of IRC 501(c)(3). The factors listed in the G.C.M. should be taken into consideration in determining whether elections for political party positions are elections for public office.

Additional guidance may be obtained from a definition in the private foundation excise tax regulations, Reg. 53.4946-1(g)(2)(i). However, since Reg. 53.4946-1(g)(2)(i) defines public office for a different, and more limited, purpose, it should be used with great care, particularly where elections for offices or positions in a political party are concerned. The extent of the applicability of Reg. 53.4946-1(g)(2)(i) is discussed in the following question and answer.

**4. How should the term "public office" be construed?**

When Congress enacted IRC 4941 to impose tax on acts of self-dealing between private foundations and disqualified persons, it specifically wished to include "government officials at policymaking levels" within the self-dealing orbit. Staff of the Joint Committee on Internal Revenue Taxation for use of the Senate Committee on Finance, 91st Cong., 1st Sess., Summary of H.R. 13270 (Tax Reform Act of 1969) 3 (Comm. Print 1969).

Reg. 53.4946-1(g)(2)(i) defines "public office" in order to explicate a species of "government official" that is considered a "disqualified person" for purposes of the tax; namely, persons described in IRC 4946(c)(5) as holders of an elective or appointive public office in the executive, legislative, or judicial branch of the government of a State, possession of the United States, or political subdivision or other area of any of the foregoing, or the District of Columbia, that pays gross compensation at an annual rate of $15,000 or more. In its definition, Reg. 53.4946-1(g)(2)(i) follows expressed legislative intent and places great stress on the independent performance of policy-making functions:

> *In defining the term "public office" . . . such term must be distinguished from mere public employment. Although holding a public office is one form of public employment, not every position in the employ of a State or other governmental subdivision . . . constitutes "public office." Although a determination whether a public employee holds a public office depends on the facts and circumstances of the case, the essential element is whether a significant part of the activities of a public employee is the independent performance of policy-making functions. . . . [S]everal factors may be considered as indications that a position in the executive, legislative, or judicial branch of the government of a State, . . . or political subdivision or other area of the foregoing . . . constitutes a "public office." Among such factors to be considered in addition to that set forth above, are that the office is created by the*

> *Congress, a State constitution, or the State legislature . . . and the powers conferred on the office and the duties to be discharged by such office are defined either directly or indirectly by the Congress, State constitution, or State legislature, or through legislative authority.*

The "independent performance of policy-making functions"/"mere public employment" dichotomy does not help one resolve the issue of whether an office or position in a political party is a "public office" for purposes of the prohibition on participation or intervention in a political campaign under IRC 501(c)(3). Political party officials do not engage in "the independent performance of policy-making functions," but they play a significant role in the electoral process. Consequently, other facts and circumstances, such as those set forth in the remainder of the regulation and those set forth in G.C.M. 39811, must be brought to bear on the issue.

Insofar as determining whether an executive, legislative, and judicial election involves a "public office" for purposes of IRC 501(c)(3), Reg. 53.4946-1(g)(2)(i) has greater relevance. Facts and circumstances prevail, there must be some governmental indication that the office is a public office, the officeholder must be more than a mere employee -- these are principles underlying Reg. 53.4946-1(g)(2)(i) and a determination under IRC 501(c)(3) must be consistent with those principles. (Similarly, Reg. 1.527-2(d), in discussing whether a federal, state, or local executive, legislative, or judicial office is a public office for purposes of IRC 527, provides both that the facts and circumstances of each case will be determinative and that "principles consistent" with those found under Reg. 53.4946-1(g)(2) will be applied.) Even here, however, caution is advised. One must not overemphasize "the independent performance of policy-making functions" to decide that an elective office is not a public office simply on the basis that the office's independent policy-making functions are too insignificant.[6]

Accordingly, insofar as determining under IRC 501(c)(3) whether an election is an election for a "public office," while Reg. 53.4946-1(g)(2)(i) provides some guidance, particularly where legislative, executive, and judicial offices are concerned, it should neither be read too literally nor be considered solely determinative. Rather, all the facts and circumstances of a particular case must be considered to resolve the issue.

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[6] The story of "Hymie's ferryboat" bears repeating here. Hymie Schorenstein, who was Brooklyn's district leader in the 1920's, had to deal with a complaint by one of his almost innumerable candidates that too much attention was being paid to the top of the ticket (Governor Franklin D. Roosevelt or, in an alternative version, Mayor James J. Walker). Mr. Schorenstein responded by talking about ferryboats: "When that big ferry from Staten Island sails into the ferry slip, it never comes in strictly alone. It drags in all the [garbage] from the harbor behind it. Roosevelt [or Walker] is our Staten Island ferry." It is not known, and certainly not to be presumed, that all of Mr. Schorenstein's candidates were running for offices that involved "the independent performance of policy-making functions" as the drafters of the self-dealing statutory and regulatory provisions understood it. See William Safire, Safire's Political Dictionary 317-318 (1978).

**5. What is the meaning of "offers himself, or is proposed by others?"**

Individuals who have publicly announced their intention to seek election to public office have clearly offered themselves as contestants for the office and are candidates within the meaning of IRC 501(c)(3). However, an individual who has not yet announced an intention to seek election to public office may nevertheless be considered to have offered himself or herself as a contestant for the office. See TAM 91-30-008 (Apr. 16, 1991) for a situation where an unannounced candidate's campaign committee published material regarding his record and mentioned his "prospective candidacy." The determination of when an individual has taken sufficient steps prior to announcing an intention to seek election, so that he or she may be considered to have offered himself or herself as a contestant for the office is based on the facts and circumstances.

Similarly, others may propose an individual as a contestant for a public office, even when the individual has announced an intention of not seeking election to the office. For example, in the 1992 New Hampshire Democratic Presidential Primary, there was a well publicized Draft Cuomo Committee that was urging voters to elect Mario Cuomo as a write-in candidate. Despite the fact that Governor Cuomo had indicated that he was not running for President, he was a candidate within the meaning of IRC 501(c)(3) because he was proposed as a contestant for the office of President by others. See Kevin Sack, Cuomo Tells Presidential Draft Group to End Campaign, N.Y. Times, Feb. 22, 1992, at A8; James M. Perry, A Cadre of Supporters Is Refusing To Write Off Cuomo as a Candidate, Wall St. J., Feb. 12, 1992, at A22. Therefore, in that situation, an IRC 501(c)(3) organization could not have supported or opposed Governor Cuomo as a candidate for President without violating the prohibition on political campaign activity.

Therefore, even if no other person or organization proposes an individual as a contestant for an elective public office, an IRC 501(c)(3) organization may not support the individual in an election for public office without violating the political campaign prohibition. By supporting a contestant for an elective public office, the IRC 501(c)(3) organization is proposing the individual as a "candidate" for the purposes of IRC 501(c)(3).

On the other hand, as the staff of the Joint Committee on Taxation noted, in a background paper prepared for the 1987 hearings, ". . . the fact that an individual is a prominent political figure does not make him a candidate, even if there is speculation regarding his possible future candidacy for particular offices." Staff of the Joint Committee on Taxation, 100th Cong. 1st Sess., Lobbying and Political Activities of Tax-exempt Organizations 14 (Joint Comm. Print 1987). In other words, some action must be taken to make one a candidate, but the action need not be taken by the candidate or require his consent.

**6. Can other government agency rules be used to define "candidate" for IRC 501(c)(3) purposes?**

In a word, no. The term "candidate" is set forth in both the Federal Election Commission (FEC) and Federal Communications Commission (FCC) statutes and regulations. However, these rules were drafted for different purposes, and their treatments of who is a candidate do not embrace (in fact, are antithetical to) the "offers himself, or is proposed by others" formulation of Reg. 1.501(c)(3)-1(c)(3)(iii) and Reg. 53.4945-3(a)(2).

With respect to the FEC, its principal purpose appears to be to find where a candidate's money came from, to know the amount of money contributed, and to have this information disclosed contemporaneously to the Commission. Therefore, the FEC regulations provide that an individual becomes a candidate for federal office when the individual, or another person to whom such individual has given his or her consent, has received contributions or made expenditures aggregating in excess of $5,000. 11 C.F.R. § 100.3(a). Assuming that Governor Cuomo did not give his consent to the Draft Cuomo Committee, he would not have been a candidate under the FEC regulations.[7] Similarly, an individual who does not accept contributions would not be considered a candidate for FEC purposes, but would be considered a candidate under IRC 501(c)(3). Thus, when William Proxmire did not accept contributions in his last Senatorial election campaign, he was not a candidate for FEC purposes, but an IRC 501(c)(3) organization nevertheless would have been prohibited from supporting or opposing him because he was a candidate under IRC 501(c)(3).[8]

As to the FCC, it appears that the primary purpose of its regulations is to assure that all declared candidates (and only declared candidates) have equal access to broadcasting. Consequently, its regulations define a "legally qualified candidate" as any person who (1) has publicly announced his or her intention to run for nomination for office, (2) is qualified under the applicable law to hold the office, and (3) meets one of three alternative tests concerning elections and primaries, nominations by convention or caucus, and nominations for the offices of president and vice president. 47 C.F.R. § 73.1940(a)(1), § 76.5(g)(1). It follows, therefore, that the FCC regulations have a purpose opposite to the Treasury regulations; while the FCC's regulations are somewhat exclusive, Treasury's are rather inclusive.

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[7] The 1964 New Hampshire Republican primary offers a more graphic illustration. Two individuals, Paul Goldberg and David Grindle, disappointed with the two principal Republican contenders, Senator Barry Goldwater and Governor Nelson Rockefeller, decided to run Henry Cabot Lodge for the Republican nomination. There was only one problem: Mr. Lodge, who was serving as Ambassador to South Vietnam, did not give his consent to the campaign. It was not much of a problem, however: New Hampshire required no candidate authorization; in fact, anyone could file as a Lodge candidate and there was nothing Ambassador Lodge could do to stop it. Ambassador Lodge, or more precisely Ambassador Lodge's campaign (since he was not part of it), won the primary. See Charles Brereton, First in the Nation: New Hampshire and the Premier Presidential Primary 35-51 (1987).

[8] Senator Proxmire spent $697 in his 1976 campaign. Michael Barone et al., The Almanac of American Politics 1978 918 (1977). Spending data from elections through the 2000 Congressional elections revealed that former Senator Proxmire and the late Representative William Natcher (who never crossed the $5,000 threshold in the 11 campaigns he conducted after the FEC was established) have no heirs; however, many local and some state elections involve candidates who conduct campaigns without either collecting or spending $5,000.

To summarize, while rules of other agencies, particularly the FEC, may be helpful in elucidating some aspects of the IRC's treatment of political campaign activities, the FEC and FCC definitions relating to who is a candidate are of limited value in determining who is a candidate for IRC purposes.

**7. What is meant by "does not participate in, or intervene in (including the publishing and distributing of statements)?"**

The regulations provide that activities that constitute participation or intervention in a political campaign include, but are not limited to, the publication or distribution of written or printed statements or the making of oral statements on behalf of or in opposition to a candidate for public office. Reg. 1.501(c)(3)-1(c)(3)(iii). See also Reg. 53.4945-3(a)(2). Consequently, a written or oral endorsement of a candidate is strictly forbidden. The rating of candidates, even on a non-partisan basis, also is prohibited. See Association of the Bar of the City of New York v. Commissioner, 858 F.2d 876 (2d Cir. 1988), cert. denied, 490 U.S. 1030 (1989), discussed below. Similarly, an IRC 501(c)(3) organization may not distribute partisan campaign literature, provide or solicit financial or other forms of support to or for candidates or political organizations, or establish political action committees (PACs). In situations where there is no explicit endorsement or partisan activity, there is no bright-line test for determining if the IRC 501(c)(3) organization participated or intervened in a political campaign. Instead, all the facts and circumstances must be considered. Some of the facts and circumstances to be considered in specific situations are discussed below.

**8. How does advocacy of an issue relate to the concept of participation or intervention in a political campaign?**

This question was presented in the following form at the meeting of the Exempt Organizations Committee of the ABA Tax Section, held on February 4, 1992:

> *Many charitable organizations conduct mass media advocacy on issues such as abortion rights, the environment, crime, defense spending, health care and tax reform, during non-election periods. If certain candidates become identified with positions on these issues during a campaign, must the organization alter its advocacy in order to avoid the IRC 501(c)(3) electioneering prohibition? Can the charity use the opportunity of the campaign to gain greater attention from candidates and the public, to its issues? Suppose a pro-life political group, during a campaign, heavily attacks pro-choice positions in TV ads, implying criticism of pro-choice incumbents. Can a pro-choice charity pay for TV ads to respond solely on the issues, using free air time provided by the TV station?*

No situation better illustrates the principle that all the facts and circumstances must be considered than the problem of when issue advocacy becomes participation or intervention in a political campaign. On the one hand, the Service is not going to tell IRC 501(c)(3) organizations that

they cannot talk about issues of morality or of social or economic problems at particular times of the year, simply because there is a campaign occurring. As the 1995 ABA Comments state:

> *Nothing in Section 501(c)(3) prohibits a charity from purchasing media time for a discussion of issues in furtherance of its exempt purposes, whether or not such discussion coincides with an election. A charity's issue based message should be no more limited during an election campaign than it is during any other time of the year. The fact that candidates have aligned themselves on one or another side of an issue should not impact a charity's ability to reach the public with a pure issue message,*[9] *particularly in view of the fact that the candidate's position is an external factor beyond the charity's control. The independent actions or positions of candidates should not be imputed to exempt organizations.*

In contrast to the "pure issue message" scenario set forth in the 1995 ABA Comments, an IRC 501(c)(3) organization may avail itself of the opportunity to intervene in a political campaign in a rather surreptitious manner. The concern is that an IRC 501(c)(3) organization may support or oppose a particular candidate in a political campaign without specifically naming the candidate by using code words to substitute for the candidate's name in its messages, such as "conservative," "liberal," "pro-life," "pro-choice," "anti-choice," "Republican," "Democrat," etc., coupled with a discussion of the candidacy or the election. When this occurs, it is quite evident what is happening -- an intervention is taking place. See TAM 91-17-001 (Sept. 5, 1990) for an example of coded language constituting political campaign intervention.[10]

Basically, a finding of campaign intervention in an issue advertisement requires more than just a positive or negative correspondence between an organization's position and a candidate's position. What is required is that there must be some reasonably overt indication in the communication to the reader, viewer, or listener that the organization supports or opposes a particular candidate (or slate of candidates) in an election; rather than being a message restricted to an issue. As is stated in TAM 1999-07-021 (May 20, 1998), in order to violate the political campaign prohibition, an advocacy communication "should contain some relatively clear directive that enables the recipient to know the organization's position on a specific candidate or slate of

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[9] In a footnote, the 1995 ABA Comments state: "We are assuming an issue-oriented message without coded candidate labels, calls to action, or other objectionable elements."

[10] A finding of political campaign intervention from the use of coded words is consistent with the concept of "candidate" -- the words are not tantamount to advocating support for or opposition to an entire political party, such as "Republican," or a vague and unidentifiably large group of candidates, such as "conservative" because the sender of the message does not intend the recipient to interpret them that way. Code words, in this context, are used with the intent of conjuring favorable or unfavorable images -- they have pejorative or commendatory connotations. When combined with discussions of elections, the code words also make specific candidates identifiable -- the organization would not use up air time or newspaper space with a code word if the word was not intended to communicate to the viewer, listener, or reader a specific elective choice. The voter in Vermont, hearing an exhortation regarding "liberal" candidates, may not know who fits that label in Kansas, but presumably he knows who stands for what in Vermont, which is why the code word is used in the first place. Another factor may be whether the organization has used similar language in communications outside of a campaign or only airs such communications during campaigns. The specific facts and circumstances of each case will determine whether an intervention in a political campaign has taken place.

candidates." This statement was made in the context of a determination that an organization did not participate or intervene in a political campaign when, a few days before Congressional elections, it distributed an "I'm Fed Up With Congress" communication that also encouraged its recipients to vote and to assure that others voted. With respect to this situation, TAM 1999-07-021 concluded as follows:

> *The "I'm Fed Up With Congress" communication does not clearly indicate whether [the organization] supports or opposes a specific candidate or slate of candidates. While it expresses a general dissatisfaction with Congress, it does not rise to the level expressing a position on any individual candidate or candidates. This communication could be viewed as focusing attention on the perceived abuses of the Congress or as a way of sending a message of disgust to members of Congress. The fact that no statement was made on an individual's qualifications, or lack thereof, for public office supports this view. Moreover, not all members of Congress were candidates for office in the elections of [that year]. This communication does not clearly support or oppose any single candidate or identifiable group of candidates (such as by party or a geographic location). Additionally, there is no indication in the file that the letter was sent only to specific states or congressional districts in which congressional elections targeted by the organization were occurring. Our determination with respect to this communication might be different if evidence in the file indicated that the communication was aimed at a specific candidate, specific candidates, or a specific ticket of candidates. However, the file lacks such evidence and there is no other evidence in the file that any other facts and circumstances existed indicating the letter was an intervention in a political campaign. Consequently, there is insufficient evidence to conclude that this communication constituted campaign intervention.*

Therefore, the fundamental test that the Service uses to decide whether an IRC 501(c)(3) organization has engaged in political campaign intervention while advocating an issue is whether support for or opposition to a candidate is mentioned or indicated by a particular label used as a stand-in for a candidate. Accordingly, the appropriate focus is on whether the organization, in fact, is commenting on a candidate rather than speaking about an issue.

**9. Is it feasible for the Service to adopt the FEC "express advocacy" standard?**

No, it is not feasible for the Service to adopt the FEC "express advocacy" standard to determine when participation or intervention in a political campaign on behalf of or in opposition to a candidate for public office has occurred.

The FEC's "express advocacy" standard came into being because the Supreme Court held a provision of the Federal Election Campaign Act of 1971 (FECA) relating to contributions "to reach only funds used for communications that expressly advocate the election or defeat of a clearly identified candidate." Buckley v. Valeo, 424 U.S. 1, 77 (1976). The FECA was subsequently amended to conform to the "express advocacy" requirement of Buckley. 2 U.S.C. § 431(17).

The pertinent FEC regulation, 11 C.F.R. § 100.22, provides as follows:

> *Expressly advocating* means any communication that--(a) Uses phrases such as "vote for the President," "re-elect your Congressman," "support the Democratic nominee," "cast your ballot for the Republican challenger for U.S. Senate in Georgia," "Smith for Congress," "Bill McKay in '94," "vote Pro-Life" or "vote Pro-Choice" accompanied by a listing of clearly identified candidates described as Pro-Life or Pro-Choice, "vote against Old Hickory," "defeat" accompanied by a picture of one or more candidate(s), "reject the incumbent," or communications of campaign slogan(s) or individual word(s), which in context can have no other reasonable meaning than to urge the election or defeat of one or more clearly identified candidate(s), such as posters, bumper stickers, advertisements, etc. which say "Nixon's the One," "Carter '76," "Reagan/Bush" or "Mondale!"; or
>
> (b) When taken as a whole and with limited reference to external events, such as the proximity to the election, could only be interpreted by a reasonable person as containing advocacy of the election or defeat of one or more clearly identified candidate(s) because--
>
> (1) The electoral portion of the communication is unmistakable, unambiguous, and suggestive of only one meaning; and
>
> (2) Reasonable minds could not differ as to whether it encourages actions to elect or defeat one or more clearly identified candidate(s) or encourages some other kind of action.[11]

Several cases illustrate how inapposite are the "express advocacy" standard and the statutory language of the IRC 501(c)(3) political campaign prohibition. In the first, Federal Election Commission v. American Federation of State, County and Municipal Employees, 471 F. Supp. 315 (D.D.C. 1979), the issue concerned a poster that the union had published and circulated immediately prior to the 1976 Presidential election. The poster contained a caricature of President Gerald Ford, wearing a button stating "Pardon Me" and embracing former President Nixon. The poster also contained a quote from a speech President Ford made while he was still Vice President: "I can say from the bottom of my heart the President of the United States is innocent and he is right." The court found that, although the poster did pertain to a clearly identified candidate and may have tended to

[11] 11 C.F.R. § 100.22 was promulgated in 1995. 60 Fed. Reg. 35,304 (July 6, 1995). Since that time, subsection (b) of the regulation, which was based on the Ninth Circuit's opinion in FEC v. Furgatch, 807 F.2d 857 (1987), has been the subject of litigation. In Maine Right to Life Committee, Inc. v. Federal Election Commission, 914 F. Supp. 8 (D.Me. 1996), aff'd, 98 F.3d 1 (1st Cir. 1996), cert. denied, 118 S. Ct. 52 (1997), the court ruled that subsection of the regulation exceeded the FEC's statutory authority because it broadened the definition of express advocacy beyond the Supreme Court's interpretation. A similar conclusion was reached in Right to Life of Dutchess County, Inc. v. Federal Election Commission, 6 F. Supp. 2d 248 (S.D.N.Y. 1998). For a discussion of some recent judicial treatment of the express advocacy standard, see Kenneth A. Gross, "Issue Advertisements: The First Amendment Is Not a Loophole," in Political Activities: Nonprofit Speech, New York University School of Law National Center on Philanthropy and the Law Conference (1998).

influence voting, it did not contain "express advocacy" under Buckley v. Valeo. Another case, Orloski v. Federal Election Commission, 795 F.2d 156 (D.C. Cir. 1986), concerned corporate contributions to a picnic held immediately before an election by a "Senior Citizens Advisory Committee" established years before by the incumbent congressional candidate. Campaign posters were placed throughout the park, although not in the picnic area. Members of the candidate's staff planned and attended the picnic; they distributed information on social security, as well as a "senior citizen's report" bearing the candidate's name. No express advocacy of the election of the candidate or the defeat of his opponent took place at the event, however; nor was there any solicitation of contributions. Under these circumstances, the court upheld the FEC's determination that the event was "nonpolitical," the picnic's purpose was other than to influence a federal election, and the corporate donations were not contributions.

A more recent case is Federal Election Commission v. The Christian Coalition, 52 F. Supp. 2d 45 (D.C.D.C. 1999). At the beginning of the opinion, the court stated the issue concerning express advocacy as follows:

> *The question presented is whether "express advocacy" by corporations and labor organizations is limited to communications that use specified phrases, such as "vote for Smith" or "support Robinson," or whether a more substantive inquiry into the clearly intended effect of a communication is permissible. The FEC advocates a substantive inquiry and alleges that the Coalition used general corporate funds to expressly advocate the election or defeat of certain candidates through a speech made by the Coalition's then-Executive Director, Ralph Reed, and by certain of the Coalition's direct mail communications.* Id. at 48.

One example of the statements at issue will suffice. Mr. Reed closed his speech, made in January 1992 to an audience in Helena, Montana, by stating: "[V]ictory will be ours. It will be ours here in Montana. And it will be ours all across America. ... We're going to see Pat Williams [an incumbent member of Congress from Montana] sent bags packing back to Montana in November of this year. And I'm going to be here to help you." Id. at 56-57.

With respect to this statement, the court concluded:

> *Although the implicit message is unmistakable, in explicit terms this is prophecy rather than advocacy. Reed predicts that victory "will be" ours and that "we're going to see" Pat Williams defeated in the November election. Neither of these verbs expressly directs the audience to do anything; the speaker has announced that this will come to be without any further action. Making the issue closer is Reed's final statement that he would return "to help you." For Reed to "help" there must be some action taking place for him to assist. However, that action -- "sending" the candidate's "bags packing" -- comes just shy of referring to the campaigning and voting against Pat Williams necessary to bring that about. Though the message is clear, it requires one inferential step too many to be unequivocally considered an explicit directive.*

> *Bound, as this Court is, by Buckley and MCFL [Federal Election Commission v. Massachusetts Citizens for Life, 479 U.S. 238 (1986), another Supreme Court "express advocacy" case)], it can only be concluded that Reed exhibited precisely the "ingenuity and resourcefulness" in his verb choice that the Buckley Court envisioned possible to circumvent the prohibition on express advocacy. As others have acknowledged, results such as this appear unsatisfyingly formalistic, allowing precisely the sort of communications Congress sought to prohibit to remain immune from liability. [Citation omitted.] But the Supreme Court felt that the First Amendment required a choice between a toothless provision and one with an overbite; results such as this flow directly from that choice.* Id. at 63.

The language of IRC 501(c)(3) indicates a much broader scope to the concept of participation or intervention in a political campaign. The statute clearly states that participation or intervention in a political campaign includes publication or distribution of statements, which denotes that prohibited political campaign activity is not to be limited to statements. It would do violence to the statute, not to mention over 45 years of interpretation, to adopt the "express advocacy" standard. Therefore, the "express advocacy" standard may not be adopted for purposes of the political campaign prohibition of IRC 501(c)(3).

**10. Can activities that are educational also result in political intervention?**

The most common question that arises in determining whether an IRC 501(c)(3) organization has violated the political campaign prohibition is whether the activities constitute political intervention or whether they are educational, one of the purposes for which an IRC 501(c)(3) organization may be formed. A misperception has developed that educational and political activities are somehow mutually exclusive. Sometimes, however, the answer is that the activity is both -- it is educational, but it also constitutes intervention in a political campaign.

"Educational" is defined for IRC 501(c)(3) purposes as including instruction of the public on subjects useful to the individual and beneficial to the community. While an educational organization may advocate a particular viewpoint, it is not educational if its principal function is the mere presentation of unsupported opinion. Examples of educational organizations include organizations whose activities consist of presenting public discussion groups, forums, panels, lectures, or other similar programs, which may be on radio or television. Reg. 1.501(c)(3)-1(d)(3). One step in determining whether an activity of an IRC 501(c)(3) organization constitutes prohibited political activity is a determination of whether it is, in fact, an educational activity, particularly when the IRC 501(c)(3) organization advocates a particular viewpoint. Rev. Proc. 86-43, 1986-2 C.B. 729, provides a methodology test for determining whether an activity is educational. It identifies several factors which indicate that the method used is not educational: (1) presentation of viewpoints unsupported by facts as a significant portion of the organization's communications; (2) distorted facts; (3) substantial use of inflammatory and disparaging terms and conclusions based on strong emotional feelings rather than objective evaluations; and (4) the approach used is not aimed at developing the audience's understanding because it does not consider their background or training

in the subject matter. The presence or absence of any of these factors is not conclusive; rather, the determination of whether the method used is educational is based upon all the facts and circumstances of the situation.

Activities that meet the methodology test of Rev. Proc. 86-43 may nevertheless constitute participation or intervention in a political campaign. For example, the court in Association of the Bar of the City of New York v. Commissioner, 858 F.2d 876 (2d Cir. 1988), cert. denied, 490 U.S. 1030 (1989), determined that the Association did not qualify as an organization described in IRC 501(c)(3) because it participated or intervened in a political campaign. The Association's disqualifying activity was the distribution of its ratings of candidates for elective judicial office as "approved," "not approved" or "approved as highly qualified." The ratings were made on the basis of a comparison of the candidate with ideal standards of competence, ability, and other qualities; they did not involve comparisons with other candidates. The court stated that although this activity was nonpartisan and in the public interest, it nevertheless constituted participation or intervention in a political campaign and the Association therefore did not qualify as an IRC 501(c)(3) organization. The Association's methodology apparently would pass muster under Rev. Proc. 86-43; it constituted prohibited political campaign activity nonetheless because it showed a bias toward particular candidates. For another example, see Rev. Rul. 67-71, 1967-1 C.B. 125, which discusses an organization created to improve a public educational system. The organization selected and supported a particular slate of candidates for the school board. The revenue ruling concludes that the organization engaged in prohibited political campaign activity, even though the selection process was completely objective and unbiased and was intended primarily to educate and inform the public about the candidates.

### C. Motivation and Absoluteness of the IRC 501(c)(3) Campaign Prohibition

**1. What is the importance of the organization's motivation?**

In the 1993 CPE Text, the question, "[d]oes the motivation of an organization determine whether the political campaign prohibition has been violated?" was answered as follows:

> *No, the motivation of an organization is irrelevant when determining whether the political campaign prohibition has been violated. Rev. Rul. 76-456, 1976-2 C.B. 151, touches on this point in concluding that where an organization is involved in upgrading the morals and ethics of political campaigning, it is nevertheless intervening in a political campaign if it solicits candidates to sign a code of fair campaign practices and releases the names of those candidates who sign and those candidates who refuse to sign. As noted above, the court in Association of the Bar of the City of New York v. Commissioner, 858 F.2d 876 (2d Cir. 1988), cert. denied, 490 U.S. 1030 (1989), upheld this view when it stated that although the Association's activity was nonpartisan and in the public interest, it nevertheless constituted participation or intervention in a political campaign. In explicating its conclusion, the court made the rather wry observation: "A candidate who receives a 'not*

> *qualified' rating will derive little comfort from the fact that the rating may have been made in a nonpartisan manner." Id. at 880. See also Rev. Rul. 67-71, 1967-1 C.B. 125.*

No statement in the 1993 CPE Text generated so much comment. As one commentator noted:

> *While the statement in the CPE Text apparently was intended to put to rest the use of "good motives" as a defense to violation of the prohibition on campaign intervention, it has -- ironically fueled a new debate as to whether "bad motives" are similarly irrelevant. For these purposes, having a "good motive" means that the activity is taken on for a demonstrably nonpartisan educational purpose. Having a "bad motive" means that the activity, although educational in nature, also has a partisan political purpose.* Celia Roady, "Political Activities of Tax-exempt Organizations: Federal Income Tax Rules and Restrictions," in Political Activities: Nonprofit Speech, New York University School of Law National Center on Philanthropy and the Law Conference (1998); reprinted in 22 Exempt Organization Tax Review, 401, 405 (Dec. 1998).[12]

One must remember here that the IRC 501(c)(3) political campaign prohibition solely refers to an activity -- participation in, or intervention in (including the publishing and distributing of statements) any political campaign on behalf of (or in opposition to) any candidate for public office. Therefore, the resolution of the "bad motive" issue depends upon the way the activity is conducted (the facts and circumstances) and upon any inquiry into the state of mind of the organization.[13]

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[12] Motivation (or intent) and its relationship to the political campaign prohibition has been the subject of several articles: Frances R. Hill, "The Role of Intent in Distinguishing Between Education and Politics," 9 Journal of Taxation of Exempt Organizations 9 (July/Aug. 1997); Jeffery L. Yablon and Edward D. Coleman, "Intent Is Not Relevant in Distinguishing Between Education and Politics," 9 Journal of Taxation of Exempt Organizations 156 (Jan./Feb. 1998); Gregory L. Colvin, "Can a Section 501(c)(3) Organization Have a Political Purpose," 10 Journal of Taxation of Exempt Organizations 40 (July/Aug. 1998); and Frances R. Hill, "Can Arguments About Subjective Intent Eliminate the Political Prohibition Under Section 501(c)(3)?," 10 Journal of Taxation of Exempt Organizations 147 (Jan./Feb. 1999). For a detailed discussion of recent pronouncements that touch upon the this issue, see Miriam Galston and Frances R. Hill, "Update on Lobbying and Political Activities," Georgetown University Conference on Exempt Organizations (1999).

[13] In the general context of determining exempt purpose, Walter J. Blum stated, in his landmark article "Motive, Intent, and Purpose in Federal Income Taxation," 34 U. Chi. L. Rev. 485, 503 n. 41 (1967):

> *[In] determining the primary purpose of an organization that operates a business and devotes all the income earned to furthering the functions which, standing alone, qualify the organization for tax exemption under § 501(c)[, state] of mind considerations seem to be totally irrelevant here. While purpose in this context conceivably could refer to the use to which all income is finally put, the history of the governing statutory provision rules out this interpretation. Purpose could also refer to the size and extent of the business activities compared to the size and extent of the business activities compared to the size and extent of activities in furtherance of exempt functions, taking into account the financial resources available for such functions. No other meaning of purpose seems germane to the issue.* (Citation omitted.)

Fundamentally, two completely parallel lines of argument have developed. One side argues that a determination of subjective intent (or "state of mind") has no place in determining whether the political campaign prohibition has been violated. That, as noted above, is absolutely correct. The other side argues that objective manifestations of intent (something far different from motive) must be taken into consideration. That is also correct. The Second Circuit, in Association of the Bar of the City of New York, used both of these completely nonconvergent ideas in making its decision. Specifically, the court dismissed the Association's nonpartisan (state of mind or motive) argument; however, the court found that the requisite objective intent (the publication of the ratings was "made with aim toward imminent elections") and this finding was crucial.

One must approach the "bad motive" scenario in the same manner -- one must look at what the organization was actually doing -- a conclusion based on some *a priori* "state of mind" determination would be improper. The most important thing to consider in determining whether an organization has participated or intervened in a political campaign is not the "motive" for the activity; rather, it is the activity itself.

**2. Is the prohibition absolute?**

Yes, the prohibition is absolute. In United States v. Dykema, 666 F.2d 1096, 1101 (7th Cir. 1981), the Seventh Circuit stated: "It should be noted that exemption is lost . . . by participation in any political campaign on behalf of any candidate for public office. It need not form a substantial part of the organization's activities." The Second Circuit agreed with this position when it held that an organization did not qualify as an IRC 501(c)(3) organization because it rated judicial candidates as a very minor part of its total activities. Association of the Bar of the City of New York v. Commissioner, 858 F.2d 876 (2d Cir. 1988), cert. denied, 490 U.S. 1030 (1989). The court rejected the organization's contention that the substantiality requirement from the lobbying activity limitations be applied to the political campaign activity prohibition. Citing United States v. Naftalin, 441 U.S. 768, 773 (1979), the court stated: "The short answer [to this argument] is that Congress did not write the statute that way." Id. at 881. The court noted that the IRC 501(c)(3) prohibition against participation or intervention in political campaigns was added some twenty years after the statutory restriction on lobbying. Therefore, the court concluded: "Had Congress intended the added exception to apply only to those organizations that devote a substantial part of their activity to participation in political campaigns, it easily could have said so. It did not." Id. at 881. Furthermore, the court noted, both houses of Congress, in their Committee Reports on the Tax Reform Act of 1969, explicitly differentiated the scope of the two proscriptions: "[A]lthough the present provisions of section 501(c)(3) permit some degree of influencing legislation by a section 501(c)(3) organization, it provides that no degree of support for an individual's candidacy is permitted." 858 F.2d at 881, citing H.R. No. 91-413, 91st Cong., 1st Sess. 32 (1969), 1969-3 C.B. 200, 221; S. Rep. No. 91-552, 91st Cong., 1st Sess. 47 (1969), 1969-3

Similarly, in determining whether an organization's business was conducted in furtherance of an exempt purpose, the court in B.S.W. Group, Inc. v. Commissioner, 70 T.C. 352, 357 (1978) stated: "Factors such as the particular manner in which an organization's activities are conducted, the commercial hue of those activities, and the existence and amount of annual or accumulated profits are relevant evidence of a forbidden predominant purpose."

C.B. 423, 454. However, as discussed below in Section D, the enactment of the IRC 4955 excise tax did provide for some relief in certain limited situations.

D. Excise Taxes and Flagrant Violations

(1) The IRC 4955 Excise Taxes

**1. Are the IRC 4955 excise taxes imposed in addition to or instead of revocation?**

Fundamentally, it appears that Congress viewed the IRC 4955 taxes, not so much as an intermediate sanction to replace revocation, but, primarily, as an additional tax, and, secondarily, as a sanction to apply instead of revocation in certain limited situations. The House Budget Committee Report (H.R. Rep. No. 100-391, 100th Cong., 1st Sess. 1623-1624 (1987)), explains the reasons for the enactment of the excise tax provisions of IRC 4955 as follows:

> *The committee believes that the penalty excise tax structure applicable under present law if a private foundation makes a prohibited political expenditure should also apply in the case of prohibited political expenditures made by a public charity.*
>
> *As the Congress concluded in adopting the two-tier foundation excise tax structure in 1969, the Internal Revenue Service may hesitate to revoke the exempt status of a charitable organization for engaging in political campaign activities in circumstances where that penalty may seem to be disproportionate - i.e., where the expenditure was unintentional and involved only a small amount and where the organization subsequently had adopted procedures to assure that similar expenditures would not be made in the future, particularly where the managers responsible for the prohibited expenditure are no longer associated with the organization. At the same time, where an organization claiming status as a charity engages in significant, uncorrected violations of the prohibition on political campaign activities, revocation of exempt status may be ineffective as penalty or as a deterrent, particularly if the organization ceases operations after it has diverted all its assets to improper purposes.*
>
> *The committee believes that the additional, two-tier excise tax structure applicable under present law to private foundations operates in a fair and effective manner and hence appropriately should be extended to public charities. The adoption of the excise tax sanction does not modify the present-law rule that an organization does not qualify for tax-exempt status as a charitable organization, and is not eligible to receive tax-deductible contributions, unless the organization does not participate in, or intervene in, any political campaign on behalf of or in opposition to any candidate for public office (secs. 501(c)(3), 170(c)(2)).* (Emphasis supplied.)

The House Budget Committee Report, therefore, specifies the situations in which Congress intended that the Service consider utilizing the excise tax instead of revocation -- where the violation was unintentional, involved only a small amount, and the organization had subsequently corrected the violation and adopted procedures to assure that similar expenditures would not be made in the future. (The House Budget Committee Report's use of "i.e.," instead of "e.g.," is significant.) Furthermore, the legislative history points out that the enactment of IRC 4955 was not intended to modify the political campaign activity prohibition of IRC 501(c)(3). Instead, Congress intended the excise tax be imposed even when the IRC 501(c)(3) organization loses its tax-exempt status as a result of the prohibited political campaign activity -- it observed that in some situations revocation alone was ineffective as a penalty. Finally, Congress intended IRC 4955 to operate as a deterrent -- the same penalty/deterrent motivation that underlaid enactment of the Chapter 42 taxes (one of which was IRC 4945) on private foundations in 1969.

The 1987 enactments were intended to strengthen, not to weaken, the prohibition on political campaign activity. As noted at the beginning of this article, at the same time that Congress enacted IRC 4955, it enacted other provisions to strengthen the ability of the Service to enforce the political campaign prohibition: the termination assessment provisions of IRC 6852, the injunctive provisions of IRC 7409, and the amendment to IRC 504 to make qualification under IRC 501(c)(4) unavailable to an organization that has lost IRC 501(c)(3) status due to political campaign activity.

Congressional intent is also reflected in the preamble to the final IRC 4955 regulations (T.D. 8628, 60 Fed. Reg. 62,209 (Dec. 5, 1995) as follows:

> *Another comment suggested that the regulations specify whether there were circumstances under which conduct would result in the imposition of a tax under section 4955 but not in revocation of exemption under section 501(c)(3). According to the statutory language and the legislative history of section 4955, the addition of that section to the Internal Revenue Code did not affect the substantive standards for tax exemption under section 501(c)(3). To be exempt from income tax as an organization described in section 501(c)(3), an organization may not intervene in any political campaign on behalf of any candidate for public office. Consistent with this requirement, section 4955 does not permit a de minimis amount of political intervention. Therefore, the final regulations have not been revised. However, there may be individual cases where, based on the facts and circumstances such as the nature of political intervention and the measures that may have been taken by the organization to prevent a recurrence, the IRS may exercise its discretion to impose a tax under section 4955 but not to seek revocation of the organization's tax-exempt status.*

In summary, Congress intended the Service to impose the IRC 4955 excise tax in addition to revocation for expenditures to intervene in a political campaign and to impose the tax instead of revocation in the limited situations where the expenditure is unintentional, small in amount, and the organization has adopted procedures to prevent future similar expenditures. See H.R. Rep. No. 100-391, 100th Cong., 1st Sess. 1623-1624 (1987)

**2. How is an IRC 501(c)(3) organization taxed under IRC 4955?**

IRC 4955(a)(1) provides for an initial tax on the organization of 10 percent of each political expenditure. IRC 4955(b)(1) imposes an additional tax on the organization of 100 percent of each political expenditure previously taxed and not corrected within the taxable period. There is no upper limit on the tax that can be levied on the organization.

**3. How are managers of an IRC 501(c)(3) organization taxed under IRC 4955?**

IRC 4955(a)(2) imposes a tax of 2½ percent of the political expenditure on any organization manager who agreed to the making of the political expenditure. Organization managers who refused to agree to all or part of the correction are subject to a tax of 50 percent of the political expenditure. Under IRC 4955(c), if more than one manager is liable for the first or second tier tax, all are jointly and severally liable. Furthermore, IRC 4955(c) provides that for "any 1 political expenditure," the first tier tax is capped at $5,000 and the second tier tax is capped at $10,000.

**4. What is a "political expenditure" for purposes of IRC 4955(d)(1)?**

The term "political expenditure" is defined in IRC 4955(d)(1) as "any amount paid or incurred by a section 501(c)(3) organization in any participation in, or intervention in (including the publication or distribution of statements), any political campaign on behalf of (or in opposition to) any candidate for public office," tracking the language of the prohibition in IRC 501(c)(3).

Additionally, the IRC 4955 regulations refer to the regulations under IRC 501(c)(3). Specifically, Reg. 53.4955-1(c)(1) provides that a political expenditure for purposes of IRC 4955 is any expenditure that would cause the organization making the expenditure to be considered an "action" organization under Reg. 1.501(c)(3)-1(c)(3)(iii). In addition to repeating the statutory prohibition against political campaign activity, Reg. 1.501(c)(3)-1(c)(3)(iii) provides that both direct and indirect participation or intervention in the political campaign process will cause the organization to be considered an action organization.

**5. What is a "political expenditure" for purposes of IRC 4955(d)(2)?**

Under IRC 4955(d)(2) certain expenditures of candidate-controlled organizations are considered political expenditures for the purpose of the tax imposed by IRC 4955. A candidate-controlled organization is an organization formed primarily for the purpose of promoting the candidacy or prospective candidacy of an individual for public office or one that is effectively controlled by a candidate or prospective

candidate and that is availed of primarily for such purposes.[14] According to the legislative history, an organization is "effectively controlled" by a candidate if the candidate "has a continuing, substantial involvement in the day-to-day operations or management of the operation." H.R. Conf. Rep. No. 100-495, 100th Cong., 1st Sess. 1021 (1987), 1987-3 C.B. 193, 301. The expenditures of a candidate-controlled organization that are considered political expenditures under IRC 4955(d)(2) are as follows:

(A) Amounts paid or incurred to the candidate for speeches or other services;

(B) Travel expenses of the candidate;

(C) Expenses of conducting polls, surveys or other studies, or preparing papers or other materials for use by the candidate;

(D) Expenses of advertising, publicity and fundraising for the candidate; and

(E) Any other expense that has the primary effect of promoting public recognition or otherwise primarily accruing to the benefit of the candidate.

**6. When is an organization effectively controlled by a candidate or prospective candidate?**

Reg. 53.4955-1(c)(2)(i) provides that, for purposes of IRC 4955(d)(2), an organization is effectively controlled by a candidate or prospective candidate only if the individual has a continuing, substantial involvement in the day-to-day operations or management of the organization. An organization will not be "effectively controlled" merely because it is affiliated with the candidate or merely because the candidate knows the directors, officers, or employees of the organization. The regulation further provides that the "effectively controlled" test is not met merely because the organization carries on its research, study, or other educational activities with respect to subject matter or issues in which the individual is interested or with which the individual is associated.

**7. When is the primary purpose of an organization promoting the candidacy or prospective candidacy of an individual for public office?**

Reg. 53.4955-1(c)(2)(ii) provides that, for purposes of IRC 4955(d)(2), a determination of whether the primary purpose of an organization is promoting the candidacy or prospective candidacy of an individual for public office is made on the basis of all the facts and circumstances. The regulation further provides that the factors to be considered include whether the studies, surveys,

[14] As originally proposed, a candidate-controlled organization was an organization formed, or availed of, substantially for purposes of promoting the candidacy or potential candidacy of an individual for public office. H.R. 2942, "Tax Exempt Lobbying and Political Activities Accountability Act of 1987" (July 15, 1987). The change from "substantially" to "primarily" was one of the few changes in the enacted version.

materials, etc., prepared by the organization are made available only to the candidate or are made available to the general public; and whether the organization pays for speeches or travel expenses of several persons. In this connection, Reg. 53.4955-1(c)(2)(ii) explicitly provides that a candidate's or prospective candidate's utilization of studies, papers, materials, etc., prepared by the organization (such as in a speech by the candidate) is not to be considered as a factor indicating that the organization has a purpose of promoting the candidacy or prospective candidacy of that individual where such papers, materials, etc., are not made available only to that individual.

**8. When are expenditures for certain voter activities treated as political expenditures?**

Expenditures for voter registration, voter turnout, or voter education constitute other expenditures that are treated as political expenditures under IRC 4955(d)(2)(E) only if the expenditures violate the prohibition on political campaign activity provided in IRC 501(c)(3). See the discussion below in Section G concerning these types of voter activities.

**9. Does IRC 4955 affect the political prohibition of IRC 501(c)(3)?**

No, IRC 4955 does not affect the political prohibition of IRC 501(c)(3). Reg. 53.4955-1(a) specifically provides that the excise taxes imposed by IRC 4955 do not affect the standards for exemption under IRC 501(c)(3). IRC 501(c)(3) organizations continue to be subject to the absolute prohibition on political campaign activity. Thus, an organization that is subject to the IRC 4955 excise tax may also have its exempt status revoked. The presence or absence of revocation proceedings against the organization does not affect the application of the IRC 4955 excise tax.

**10. How is IRC 4955 coordinated with IRC 4945?**

The tax/correction structure and the rates imposed by IRC 4955 are identical to those under IRC 4945, which imposes a tax on the taxable expenditures of a private foundation, including political expenditures. To avoid duplicating excise taxes on political expenditures by private foundations, IRC 4955(e) provides that if its taxes are imposed on a private foundation, the expenditure is not treated as a taxable expenditure under IRC 4945.

**11. How is IRC 4955 coordinated with IRC 4958?**

IRC 4958, enacted July 30, 1996,[15] imposes excise taxes on excess benefit transactions involving organizations described in IRC 501(c)(3) (other than private foundations and some other

[15] Taxpayer Bill of Rights 2, Pub. L. No. 104-168, 110 Stat. 1452.

minor exceptions) and IRC 501(c)(4).[16] As part of the enactment of IRC 4958, IRC 4955(e) was amended to provide that if the 4955 tax is imposed on a political expenditure, such expenditure will not be treated as an excess benefit for purposes of IRC 4958.

**12. How is the tax on organization managers imposed?**

Since the structure of IRC 4955 was based upon the structure of IRC 4945, the IRC 4955 regulations adopt the same basic standards as those contained in Reg. 53.4945-1(a)(2) for the imposition of tax under IRC 4955(a)(2) on organization managers that agree to the making of the political expenditure. Reg. 53.4955-1(b)(1) provides that the excise tax under IRC 4955(a)(2) will only be imposed on a manager if three conditions are met:

(1) A tax is imposed on the organization by IRC 4955(a)(1);

(2) The organization manager knows that the expenditure to which the manager agrees is a political expenditure; and

(3) The agreement is willful and is not due to reasonable cause.

**13. What is the meaning of "organization manager" for purposes of IRC 4955?**

IRC 4955(f)(2) specifies that the term "organization manager" on whom tax may be imposed means any officer, director, or trustee of the organization (or individual having similar powers or responsibilities), or any employee of the organization having power or authority with respect to the expenditure. To be subject to the tax under IRC 4955(a)(2), the manager must either be authorized to approve, or to exercise discretion in recommending approval of, the making of the expenditure by the organization, or be a member of a group (such as the organization's governing body) which is so authorized. Reg. 53.4955-1(b)(2)(i).

**14. When is an officer of an organization considered an organization manager?**

An officer of the organization is the person designated as such under the organizing documents of the organization or any person who regularly exercises general authority to make administrative or policy decisions on its behalf. An independent contractor, acting as an attorney, accountant, or other advisor, is not an officer of the organization. Reg. 53.4955-1(b)(2)(ii). An individual is only considered an officer of the organization for purposes of IRC 4955(f)(2)(B) if that individual is an employee within the meaning of

[16] The IRC 4958 excise taxes apply to excess benefit transactions occurring on or after September 14, 1995. Pub. L. 104-68, § 1311(d)(1). They do not apply, however, to any benefit arising from a transaction pursuant to any written contract that was binding on September 13, 1995, and continued in force through the time of the transaction. Pub. L. 104-68, § 1311(d)(2).

IRC 3121(d)(2) and only if he or she has final authority or responsibility (either officially or effectively) with respect to the political expenditure. Reg. 53.4955-1(b)(2)(iii).

**15. When has an organization manager agreed to the political expenditure?**

Reg. 53.4955-1(b)(3) provides that an organization manager agrees to the expenditure if he or she "manifests approval of the expenditure which is sufficient to constitute an exercise of the organization manager's authority to approve, or to exercise discretion in recommending approval of, the making of the expenditure by the organization." Furthermore, the regulation provides that "[t]he manifestation of approval need not be the final or decisive approval on behalf of the organization." Therefore, the provision extends beyond the person who gave final approval to include other managers who recommended approval.

**16. When does an organization manager know that an expenditure is a political expenditure?**

In determining whether the organization manager knows that an expenditure is a political expenditure, the regulations follow Reg. 53.4945-1(a)(2)(iii) in establishing the general rule. Reg. 53.4955-1(b)(4)(i) provides that an organization manager is considered to have known that the expenditure to which he or she agreed is a political expenditure only if the following conditions are met:

(1) The manager has actual knowledge of sufficient facts so that, based solely upon these facts, the expenditure would be a political expenditure;

(2) The manager is aware that such an expenditure under these circumstances may violate the provisions of federal tax law governing political expenditures; and

(3) The manager negligently fails to make reasonable attempts to ascertain whether the expenditure is a political expenditure, or the manager is aware that it is a political expenditure.

The regulations also amplify this general rule by providing that, for purposes of IRC 4955, the mere fact that an organization manager has reason to know that an expenditure is a political expenditure does not, by itself, mean that the manager has actual knowledge that it is a political expenditure. Nevertheless, evidence showing that the manager had reason to know is relevant in determining whether the manager had actual knowledge. Reg. 53.4955-1(b)(4)(ii).

**17. When is an organization manager's agreement to a political expenditure willful?**

Reg. 53.4955-1(b)(5) provides that an organization manager's agreement to a political expenditure is willful if it is voluntary, conscious, and intentional. No motive to avoid the restrictions of the law or the incurrence of any tax is necessary to make an agreement willful; however, to be a willful agreement, the manager must know that the expenditure is a political expenditure.

**18. When are an organization manager's actions considered to be due to reasonable cause?**

Reg. 53.4955-1(b)(6) provides that an organization manager's actions are due to reasonable cause if the manager has exercised his or her responsibility on behalf of the organization with ordinary business care and prudence.

**19. May an organization manager rely on the advice of counsel?**

Yes, an organization manager may rely on the advice of counsel. Reg. 53.4955-1(b)(7) provides that an organization manager's agreement to an expenditure is ordinarily considered not knowing or willful and is ordinarily considered due to reasonable cause if the manager, after full disclosure of the factual situation to legal counsel (including house counsel) relies on the advice of counsel expressed in a reasoned written legal opinion that an expenditure is not a political expenditure under IRC 4955 (or that expenditures conforming to certain guidelines are not political expenditures).

**20. What if a written legal opinion reaches a conclusion subsequently determined to be incorrect?**

Reg. 53.4955-1(b)(7) provides that, for the purpose of determining whether a manager knowingly and willfully agreed to a political expenditure, a written legal opinion is considered reasoned even if it reaches a conclusion that is subsequently determined to be incorrect, so long as the opinion addresses itself to the facts and applicable law. The following sentence of the regulation, however, adds a cautionary note: "A written legal opinion is not considered reasoned if it does nothing more than recite the facts and express a conclusion."

**21. What if the organization manager does not seek advice of counsel?**

The absence of advice of counsel with respect to an expenditure, by itself, does not give rise to any inference that an organization manager agreed to the making of a political expenditure knowingly, willfully, or without reasonable cause. Reg. 53.4955-1(b)(7).

**22. May an organization rely upon advice of counsel?**

No, the advice of counsel provision does not apply to the organization itself. Since IRC 4955(a)(1) imposes the tax on an organization without regard to whether its actions were willful or due to reasonable cause, the same reasoned written legal opinion from legal counsel that would protect an organization manager from tax would not protect the organization from the excise tax.

**23. Who bears the burden of proof?**

Under Reg. 53.4955-1(b)(8), which provides that IRC 7454(b) controls, the Service bears the burden of proof with respect to whether an organization manager knowingly and without reasonable cause agreed to the making of a political expenditure.

**24. How are the IRC 4955 excise taxes computed and reported?**

Form 4720 is used to compute and report the IRC 4955 excise taxes. An organization liable for tax imposed by IRC 4955(a) must file its Form 4720 by the unextended due date for filing its annual information return under IRC 6033 or, if the organization is exempt from filing, the date it would be required to file an annual information return if it were not exempt from filing. A person whose taxable year ends on a date other than the date of the end of the organization's taxable year must file his or her Form 4720 on or before the 15th day of the fifth month following the close of the person's taxable year. Reg. 53.6071-1(e).

**25. What if the political expenditure was not "willful and flagrant" and was "corrected"?**

Reg. 53.4955-1(d) provides that, if the organization or organization manager establishes to the satisfaction of the Service that a political expenditure was not "willful and flagrant" and was "corrected," no initial (first tier) tax will be imposed under IRC 4955(a), or the initial tax will be refunded.

**26. What is the meaning of "willful and flagrant"?**

The IRC 4955 regulations contain no definition of "willful and flagrant."[17] There is,

[17] The preamble to the final IRC 4955 regulations noted as follows:

> *One comment requested that the regulations provide more detail on the type of behavior that would be considered flagrant under sections 6852 and 7409. Since a determination of when a specific act or acts by an organization is flagrant*

however, a very general definition of "willful and flagrant" in Reg. 1.507-1(c)(2) for purposes of the IRC 507 voluntary termination tax. Reg. 1.507-1(c)(2) provides that an act is deemed willful and flagrant if it is "voluntarily, consciously, and knowingly" committed in violation of any such rule and "appears to a reasonable man to be a gross violation...."

**27. What is the meaning of "correction" in this context?**

Reg. 53.4955-1(e) provides that correction of a political expenditure means recovering the expenditure to the extent possible and establishing safeguards to prevent future political expenditures. Under Reg. 53.4955-1(e)(1) "recovery of expenditure" means recovering part or all of the expenditure to the extent possible, and, where full recovery cannot be accomplished, by any additional corrective action that the Commissioner might prescribe. (The regulation further provides, however, that the organization that made the political expenditure is not under any obligation to attempt to recover the expenditure by legal action if the action would in all probability not result in the satisfaction of execution on a judgment.)

**28. May the taxes under IRC 4955 be abated?**

If the political expenditure subject to tax under IRC 4955 is corrected within the correction period, IRC 4961 provides that any second tier tax imposed with respect to that expenditure may be abated. The amount that may be abated will include any interest, additions to the tax, and additional amounts also assessed. The correction period is the period beginning on the date on which the political expenditure occurs and ending 90 days after the date of mailing a notice of deficiency with respect to the second tier tax. IRC 4962(e).

If the organization establishes that the political expenditure was not willful and flagrant and it is corrected within the correction period, the first tier tax may be abated, including any interest. IRC 4962.

**29. When may requests for abatement be made?**

Requests for abatement may be made during an examination, after a 30-day letter or a 90-day letter has been issued, in a protest of a tax due and assessed on Form 4720, or in a request filed (formally or informally) after the tax has been assessed and paid. If the tax has been paid, the request for abatement is treated as a claim, even though abatements differ fundamentally from

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*depends on the facts and circumstances of individual cases, the IRS and the Treasury Department believe that, to the extent guidance is necessary on this issue, it is better rendered in a form other than through regulations. Therefore, the final regulations do not expand on the definition of flagrant.* 60 Fed. Reg. 62,209-62,210 (Dec. 5, 1995).

claims. (Abatement is discretionary relief from an obligation; a claim disputes the existence of an obligation.)

Because abatement can be requested at any time, it should be considered in every case where the IRC 4955 first tier tax has been imposed. If the facts support abatement, the tax should be abated even if the taxpayer has not raised the issue. If the facts do not support abatement, the file should document why.

(2) The Treatment of Flagrant Political Expenditures

**1. What are the termination assessment provisions for flagrant political expenditures?**

IRC 6852 provides that the Service may immediately determine the amount of income and IRC 4955 tax, for that year and the immediately preceding tax year, due from an IRC 501(c)(3) organization that flagrantly violates the political campaign prohibition, which shall be immediately due and payable. The Service will immediately assess the tax so determined and demand payment from the organization. The determination and assessment of the tax under IRC 6852 terminates the taxable year of the IRC 501(c)(3) organization.

**2. What are the injunction provisions for flagrant political expenditures?**

IRC 7409 grants authority to the Service to seek an injunction against an IRC 501(c)(3) organization that flagrantly violates the political campaign prohibition to prevent further political expenditures by the organization. An injunction may be sought only if three conditions are met:

(A) The organization has been notified that the Service intends to seek an injunction if the making of political expenditures does not immediately cease;

(B) The Commissioner has personally determined that the organization has flagrantly violated the political campaign activity prohibition; and

(C) The Commissioner has personally determined that injunctive relief is appropriate to prevent future political expenditures.

E. Attribution of the Acts of Individuals to IRC 501(c)(3) Organizations

**1. When may the act of an individual official be attributed to the organization?**

The prohibition on political campaign activity applies only to IRC 501(c)(3) organizations, not to the activities of individuals in their private capacity. The prohibition against political campaign activity does not prevent an organization's officials from being involved in a

political campaign, so long as those officials do not in any way utilize the organization's financial resources, facilities, or personnel, and clearly and unambiguously indicate that the actions taken or the statements made are those of the individuals and not of the organization.

On the other hand, since an IRC 501(c)(3) organization acts through individuals, sometimes the political activity of an individual may be attributed to the organization. As in other situations where the political campaign prohibition is concerned, the determination of whether the act of an individual will be attributed to an IRC 501(c)(3) organization is based on the relevant facts and circumstances. In particular, when officials of an IRC 501(c)(3) organization engage in political activity at official functions of the organization or through the organization's official publications, the actions of the officials are attributed to the IRC 501(c)(3) organization. Use of the IRC 501(c)(3) organization's financial resources, facilities, or personnel is also indicative that the actions of the individual should be attributed to the organization.

An IRC 501(c)(3) organization acts through individuals such as its officers, directors and trustees. The officers, directors, or trustees of the organization are the ones who make the decisions for the organization and communicate those decisions to others. Officials acting in their individual capacity may be identified as officials of the organization so long as they make it clear that they are acting in their individual capacity, that they are not acting on behalf of the organization, and that their association with the organization is given for identification purposes only. If it is not made clear that the official's association with the organization is given only for purposes of identification, the individual's acts may be attributed to the IRC 501(c)(3) organization since the organization typically acts through its officials. Actions and communications by the officials of the organization that are of the same character and method as authorized acts and communications of the organization will be attributed to the organization.

Therefore, when an official of an IRC 501(c)(3) organization endorses a candidate somewhere other than in the organization's publications or at its official functions, and the organization is mentioned, it should be made clear that such endorsement is being made by the individual in his or her private capacity and not on the organization's behalf. The following language would serve as a sufficient disclaimer: "Organization shown for identification purposes only; no endorsement by the organization is implied." However, as stated earlier, if the endorsement occurs in the organization's publication or at its official function, such a disclaimer is insufficient to avoid attribution of the endorsement to the organization.

**2. When may the acts of individuals other than officials be attributed to an organization?**

An IRC 501(c)(3) organization may also act or communicate with others through the authorized actions of its employees or members. There must be real or apparent authorization by the IRC 501(c)(3) organization of the actions of individuals other than officials before the actions of those individuals will be attributed to the organization. In general, the principles of agency will be applied to determine whether an individual engaging in political activity was acting with the authorization of the IRC 501(c)(3) organization. See, e.g., G.C.M. 34631 (Oct. 4, 1971). The

actions of employees within the context of their employment generally will be considered to be authorized by the organization.

Acts of individuals that are not authorized by the IRC 501(c)(3) organization may be attributed to the organization if it explicitly or implicitly ratifies the actions. A failure to disavow the actions of individuals under apparent authorization from the IRC 501(c)(3) organization may be considered a ratification of the actions. To be effective, the disavowal must be made in a timely manner equal to the original actions. The organization must also take steps to ensure that such unauthorized actions do not recur.

The actions of students generally are not attributed to an educational institution unless they are undertaken at the direction of and with authorization from a school official. (Note that actions by a person in excess of his official authority should not, as a rule, be considered those of the organization. If the organization allows such usurpation of authority to go unchallenged, however, it impliedly ratifies the act. See G.C.M. 34523 (June 11, 1971).) For instance, the individual political campaign activities of students were not attributed to the university in Rev. Rul. 72-512, 1972-2 C.B. 246. Had the faculty members specified the candidates on whose behalf the students should campaign, the actions of the students would be attributable to the university since the faculty members act with the authorization of the university in teaching classes.

For example, in G.C.M. 39414 (Feb. 29, 1984), the political campaign activities of individual members were attributed to an IRC 501(c)(3) organization. The organization's publication stated that the organization would be sending members to work on the campaign, members identified themselves as representing the organization, and officials made no effort to prevent the members' activities.

F. Relationship of IRC 501(c)(3) Organizations with Organizations That Conduct Political Campaign Activities

**1. Can an IRC 501(c)(3) organization establish a political action committee (PAC) to engage in political campaign activity?**

No, an IRC 501(c)(3) organization may not establish a PAC to engage in political campaign activity. When the statute governing political organizations, IRC 527, was enacted, the Senate Finance Committee's Report stated: "This provision is not intended to affect in any way the prohibition against certain exempt organizations (e.g., sec. 501(c)(3)) engaging in 'electioneering' or the application of the provisions of section 4945 to private foundations." S. Rep. No. 93-1374, 93d Cong., 2d Sess. 30 (1974), 1975-1 C.B. 517, 534. Consequently, Reg. 1.527-6(g) provides:

> *Section 527(f) and this section do not sanction the intervention in any political campaign by an organization described in section 501(c) if such activity is inconsistent with its exempt status under section 501(c). For example, an*

> *organization described in section 501(c)(3) is precluded from engaging in any political campaign activities. The fact that section 527 imposes a tax on the exempt function income (as defined in section 1.527-2(c)) expenditures of section 501(c) organizations and permits such organizations to establish separate segregated funds to engage in campaign activities does not sanction the participation in these activities by section 501(c)(3) organizations.*

In Branch Ministries v. Rossotti, 211 F.3d 137 (D.C. Cir. 2000), the court affirmed the revocation of the IRC 501(c)(3) status of a church. The church had published advertisements in major newspapers four days before the 1992 presidential election urging people not to vote for then presidential-candidate Bill Clinton because of his position on certain moral issues and soliciting tax-deductible contributions for the advertisements. In holding that the IRC 501(c)(3) prohibition did not violate the organization's constitutional rights, the court agreed with Branch Ministries' assertion that the church could not set up a PAC, but stated that there were other methods to achieve the political communication goals of the church that were not supported by tax-deductible contributions.

**2. May the directors of an IRC 501(c)(3) organization form a PAC without it being attributed to the IRC 501(c)(3) organization?**

This question frequently arises because the FEC, in Advisory Opinion 1984-12 (May 31, 1984), allowed the directors of a charitable corporation, acting in their individual capacities, to establish a non-connected political action committee. The opinion held that this did not violate the FECA prohibition on corporate involvement in elections since it was the directors and not the charitable corporation that established the PAC.

What was stated at the outset of the discussion of attribution bears repeating here: The prohibition on political campaign activity applies only to IRC 501(c)(3) organizations, not to the political campaign activities of individuals in their private capacity. The prohibition against political campaign activity does not prevent an organization's officials from being involved in a political campaign, so long as those officials do not in any way utilize the organization's financial resources, facilities, or personnel, and clearly and unambiguously indicate that the actions taken or the statements made are those of the individuals and not of the organization. Whether the individuals are truly acting in their own capacity is an evidentiary question. Unfavorable evidence would include any similarity of name between the IRC 501(c)(3) organization and the PAC, any excessive overlap of directors without a convincing explanation for the situation, and any sharing of facilities.

**3. When will the political activities of a related IRC 501(c)(4) organization (or its separate segregated fund) be attributed to an IRC 501(c)(3) organization?**

A number of IRC 501(c)(3) organizations have related IRC 501(c)(4) organizations that conduct political campaign activities, usually through a PAC (an IRC 527(f) separate segregated fund).[18] The Service must respect the separate legal status of entities established for a valid business purpose unless one organization is a sham or acting as a mere agent of the other. See Moline Properties, Inc. v. Commissioner, 319 U.S. 436 (1943). So long as the organizations are kept separate (with appropriate record keeping and fair market reimbursement for facilities and services), the activities of the IRC 501(c)(4) organization or of the PAC will not jeopardize the IRC 501(c)(3) organization's exempt status. See, e.g., PLR 2001-03-084 (Oct. 24, 2000). However, the political campaign activities of the affiliated IRC 501(c)(4) organization, or of the PAC it establishes, should not be an attempt to accomplish indirectly what the IRC 501(c)(3) organization could not do directly. Facts and circumstances prevail here also.

In Regan v. Taxation with Representation of Washington, 461 U.S. 540 (1983), the Supreme Court upheld the prohibition of substantial lobbying by IRC 501(c)(3) organizations. Taxation with Representation of Washington ("TWR") was an organization that applied for recognition of exemption from federal income tax as an organization described in IRC 501(c)(3), but was denied exemption because it proposed to engage in substantial lobbying activity. TWR was the successor to two other organizations, an IRC 501(c)(3) organization and a related IRC 501(c)(4) organization. TWR itself would have qualified as an IRC 501(c)(4) organization. The Court noted that the two primary differences between IRC 501(c)(3) organizations and IRC 501(c)(4) organizations are that contributions to IRC 501(c)(3) organizations are tax-deductible while contributions to IRC 501(c)(4) organizations are not and that IRC 501(c)(4) organizations are permitted to engage in substantial lobbying activities to advance their exempt purposes while IRC 501(c)(3) organizations are not. The Court stated that it was not unconstitutional for Congress to provide that tax-deductible contributions could not be used to support substantial lobbying activities by tax-exempt organizations. The concurring opinion expressly relied on the fact that an IRC 501(c)(3) organization could establish a related IRC 501(c)(4) organization to conduct substantial lobbying activities. So long as the two organizations are separately incorporated and maintain adequate records to show that tax-deductible contributions are not used to support the substantial lobbying activities of the IRC 501(c)(4) organization, those activities will not be attributed to the IRC 501(c)(3) organization.[19]

[18] The discussion that follows applies equally to other types of IRC 501(c) organizations that are permitted to engage in some political activity without jeopardizing their exempt status, such as IRC 501(c)(5) labor organizations and IRC 501(c)(6) business leagues. For a discussion of political campaign activities with respect to these organizations, see Part 4. See, also, Appendix IV for brief descriptions of some of the types of affiliations possible with exempt organizations.

[19] For an overview of the federal tax rules concerning political and lobbying activities by exempt organizations, see 2000 Joint Committee Report. For a detailed discussion of the rules concerning exempt organizations and lobbying activity, see 1997 CPE Text.

A similar distinction arises concerning political campaign activities. An IRC 501(c)(4) organization is permitted to engage in some political campaign activity while an IRC 501(c)(3) organization is not. As in the case of substantial lobbying activities, the organizations must be separately incorporated and maintain adequate records to ensure that tax-deductible contributions are not used to support the political campaign activity of the IRC 501(c)(4) organization or any PAC it establishes. In Branch Ministries v. Rossotti, 211 F.3d 137 (D.C. Cir. 2000), the court referred to the concurring opinion in Regan v. Taxation with Representation of Washington and noted that while Branch Ministries could not itself establish a PAC, it could initiate a series of steps to achieve the desired political communication without using tax-deductible funds to support the activity. Specifically, it could establish an IRC 501(c)(4) organization that could establish a PAC provided the IRC 501(c)(4) organization was separately incorporated and the organizations maintained records to show that tax-deductible contributions to the church had not been used to support the political activities conducted by the IRC 501(c)(4) organization's PAC.

The mere fact that an IRC 501(c)(4) organization has a similar name to an IRC 501(c)(3) organization is not sufficient to cause the activities of the IRC 501(c)(4) organization (or an IRC 527 organization established by the IRC 501(c)(4) organization) to be attributed to the IRC 501(c)(3) organization. First, similarity of names is not always an indication that organizations are affiliated. For example, two organizations in separate states that are interested in promoting space exploration may adopt the name "The Yuri Gagarin Society" without being affiliated with each other.

Second, even if the organizations are affiliated, similarity in names alone does not cause the activities of one to be attributed to the other. In Center on Corporate Responsibility, Inc. v. Schultz, 368 F.Supp. 863 (D.D.C. 1973), the court held that an organization qualified as an IRC 501(c)(3) organization even though it had established an affiliated taxable corporation with a similar name to carry on activities that it could not otherwise carry on itself. The court recognized that although they had similar names, purposes, and board members, they were separate entities with separate bank accounts and activities. The court did not attribute the activities of the taxable organization to the non-profit organization.

Furthermore, when an organization, such as an IRC 501(c)(4) organization, establishes a federal PAC, it is required to include its full name in the name of the PAC. See 11 C.F.R. § 102.14(c). If the IRC 501(c)(4) organization has also established a related IRC 501(c)(3) organization with a similar name, the activities of the IRC 527 organization are not going to be attributed to the IRC 501(c)(3) organization simply because the IRC 501(c)(3) organization and the IRC 501(c)(4) organization have similar names and the name of the IRC 501(c)(4) organization is included in the name of the PAC. There must be something more to indicate that the IRC 501(c)(3) organization is supporting the PAC, for example, the use of the IRC 501(c)(3) organization's tangible or intangible assets.

Situations of particular concern when an IRC 501(c)(3) organization has a related IRC 501(c)(4) organization include those in which the two organizations share staff, facilities, or other expenses or in which the two organizations conduct joint activities requiring an allocation of income and expenses. Any allocation of income or expenses between the two organizations must be carefully reviewed to ensure that the allocation method is appropriate and that the resources of

the IRC 501(c)(3) organization are not being used to subsidize the political campaign activity of the IRC 501(c)(4) organization or its PAC. The determination of whether the allocation method used is appropriate is based upon the facts and circumstances. An arm's length standard must be utilized.

An IRC 501(c)(3) organization's resources include intangible assets, such as its logos, trademarks and goodwill, that may not be used to support the political campaign activities of another organization. The licensing of an IRC 501(c)(3) organization's logos or trademarks to an IRC 527 organization may be considered official sanction by the IRC 501(c)(3) organization of the political activities of the IRC 527 organization. In addition, any attempt at joint fundraising should be carefully scrutinized from the aspect of whether the IRC 501(c)(3) organization is allowing its name or its goodwill to be used to further an activity forbidden to it. For example, if a well-known IRC 501(c)(3) organization "jointly" sponsors a fundraising event with a lesser-known PAC, there is a strong suspicion that the IRC 501(c)(3) organization's drawing power is being used to aid the political intervention activities of the PAC. In this situation, there would be something more than the mere similarity in name discussed above.

G. Particular Situations Involving the Application of Facts and Circumstances Tests

**1. May an IRC 501(c)(3) organization's publication contain material relating to candidates during an election campaign?**

Frequently, IRC 501(c)(3) organizations publish periodicals, including magazines and weekly newspapers. These periodicals contain various stories of interest to the readership, including discussions of various issues of importance to the organization. During an election campaign, news stories, by definition, may involve reporting on a particular candidate's activities.

The fundamental distinction here is between what is news coverage and what is an attempt through editorial policy to promote or oppose a particular candidate. Questions, of necessity, are highly factual, but the overall focus is on the policy of the organization. What does the publication normally do when it covers news stories? Does it have a policy of only covering particular candidates? Does it, in fact, only cover particular candidates? Is the coverage slanted to show any particular candidate in a favorable or unfavorable light?

For example, as the 1995 ABA Comments state:

> *.... Because of the highly factual nature of such determinations, this is a difficult area in which to advise or enforce, particularly with respect to weekly or daily publications.*
>
> *Nonetheless, two poles should be distinguished: editorials favoring or opposing certain candidates (which should always be regarded as political campaign activity) and pure discussions of issues without endorsements or opposition to particular candidates (which should never be seen as political campaign activity)....*

While the Service generally agrees with this, the concern is where the article moves from a "pure discussion of issues without endorsement" to a biased discussion favoring the views of candidates with similar views to those espoused by the organization.

**2. May an IRC 501(c)(3) organization publish "voters' guides"?**

A number of IRC 501(c)(3) organizations publish "voters' guides." In some instances, these publications contain the voting records of incumbent legislators and are distributed with the stated purpose of educating voters. In other instances, the publications consist of candidate questionnaires containing the responses of various candidates to a particular office to a variety of questions posed by the organization. While there are other types of "voters' guides," voting records and candidate questionnaires have been specifically addressed in precedential guidance.

Although commonly referred to as "voters' guides," these activities do not always constitute electioneering activity. In some cases, activities described as "voters' guides" may in fact be in support of the legislative activities of the organization. In other situations, "voters' guides" may be published to encourage participation in the electoral process. However, there are "voters' guides" that constitute participation or intervention in a political campaign on behalf or in opposition to a candidate for public office. The following questions address the factors considered with respect to voting records and candidate questionnaires. Similar facts and circumstances should be considered when determining whether other types of "voters' guides" violate the political campaign prohibition.

**3. What are the rules relating to publication of legislators' voting records?**

These "voters' guides" publications contain the voting records of incumbent legislators. They may be distributed with the stated purpose of educating voters or they may be distributed for purposes unrelated to a campaign (for example, lobbying). Some of the facts and circumstances that have been considered in determining whether the publication of these voters' guides constitutes prohibited political campaign activity include whether the incumbents are identified as candidates; whether the incumbents' positions are compared to the positions of other candidates or the organization's position; the timing, extent, and manner in which the voters' guide is distributed; and the breadth or narrowness of the issues presented in the voters' guide.

An IRC 501(c)(3) organization that annually prepared a compilation of voting records of all members of Congress on major legislation involving a wide range of subjects and made it generally available to the public was not participating or intervening in a political campaign. The compilation contained no editorial opinion and its contents and structure did not indicate approval or disapproval of any members or their voting records. Rev. Rul. 78-248, 1978-1 C.B. 154, Situation 1. On the other hand, an IRC 501(c)(3) organization that compiled the voting records of incumbents on selected land conservation issues of importance to the organization and distributed the compilation widely among the electorate during an election campaign did participate or intervene in a political

campaign. Although the guide contained no express statements in support of or in opposition to any candidate, the organization concentrated on a narrow range of issues in the voters' guide and widely distributed it among the electorate during an election campaign, which indicated that its purpose was not nonpartisan voter education. Rev. Rul. 78-248, 1978-1 C.B. 154, Situation 4.[20]

Rev. Rul. 80-282, 1980-2 C.B. 178, discusses a situation where an IRC 501(c)(3) organization intended to publish a summary of the voting records of all incumbent members of Congress on selected legislative issues of importance to the organization. The summary would be published as soon as was practicable after the close of the congressional session in a regular issue of its monthly newsletter, which would be distributed to the usual subscribers. The newsletter would indicate the organization's position on the issues and the summary would indicate whether each legislator voted in accordance with the organization's position on each issue. The newsletter was politically nonpartisan and would not contain any reference to or mention of any political campaigns, elections, or candidates or any statements expressly or impliedly endorsing or rejecting any incumbent as a candidate for public office. In addition, no mention would be made of an individual's overall qualification for public office, the newsletter would not compare candidates who might be competing with the incumbent for public office, and the newsletter would point out the limitation of judging the qualifications of an incumbent on the basis of a few selected votes. The summary would contain the voting records of all incumbents and would not identify candidates for reelection as such. The publication of the voting records would not be geared to the timing of any federal election and distribution would not be targeted toward particular areas in which elections were occurring. The ruling holds that the organization was not participating or intervening in a campaign within the meaning of IRC 501(c)(3), even though the organization indicated whether the votes of the incumbents agreed with its position. The critical factors here were that the timing and distribution of the newsletter indicated its publication was not aimed at any elections and the newsletter did not identify which of the incumbents were candidates for reelection.

### 4. What are the rules relating to candidate questionnaires?

Another "voters' guide" activity of IRC 501(c)(3) organizations that may qualify as educational is the publication of candidate questionnaires. These questionnaires, the results of which are distributed to the voting public, typically consist of candidates' responses to questions posed by the organization. Some of the facts and circumstances considered in determining whether the publication of the questionnaire constitutes prohibited political campaign activity are as follows:

(A) Whether the questionnaire is sent to all candidates;

(B) Whether all responses are published;

(C) Whether the questions cover a wide variety of issues;

[20] The range of issues criterion is contextual -- if the office being contested has a limited function, for example, a seat on a school board, the range of issues is limited to what is relevant to that office.

(D) Whether the questions indicate a bias toward the organization's preferred answer;

(E) Whether the responses are compared to the organization's positions on the issues; and

(F) Whether the responses are published as received without editing by the organization.

Rev. Rul. 78-248, 1978-1 C.B. 154, Situation 2, describes an IRC 501(c)(3) organization that solicited from all candidates for governor a brief statement of the candidate's position on a wide variety of issues. The results then were published in a voters' guide made generally available to the public. The issues were selected by the organization solely on the basis of their interest and importance to the electorate as a whole and neither the questionnaire nor the voters' guide, in content or structure, evidenced a bias or preference with respect to the views of any candidate or group of candidates. The revenue ruling holds that the organization had not participated or intervened in a political campaign within the meaning of IRC 501(c)(3). On the other hand, an IRC 501(c)(3) organization that published a voters' guide based on responses from candidates to a questionnaire did participate or intervene in a political campaign when the questions to the candidates evidenced a bias on certain issues. Rev. Rul. 78-248, 1978-1 C.B. 154, Situation 3.[21]

**5. May voter education material prepared by a candidate, political party, or PAC be distributed by a IRC 501(c)(3) organization?**

No. Voter education material prepared by a candidate, political party, or PAC should not be distributed by a IRC 501(c)(3) organization since, as the 1995 ABA Comments note, "such material is prepared and distributed for the purpose of improving or diminishing a candidate's prospects to be elected."

**6. What are the rules relating to public forums for candidates?**

Public forums involving candidates for public office may qualify as exempt educational activities. However, if the forum is operated to show a bias for or against any candidate, then the

[21] The 1995 ABA Comments make the following statement regarding candidate questionnaires:

> *We recommend that the IRS address a common situation, namely, when not every candidate responds to the questionnaire. A charity should be able to publish the answers if at least two candidates respond, if the charity takes steps to remind the nonresponding candidates of the deadline for their answers, and if the charity does not cast an unfavorable light on the lack of response. However, if only one candidate from the entire field responds, the questionnaire should not be published.*

As discussed above, the test is a facts and circumstances test. In every situation, the Service must look to all of the relevant facts and circumstances, including those such as the ones suggested in the 1995 ABA Comments.

forum would be prohibited activity as it would constitute an intervention or participation in a political campaign.

An IRC 501(c)(3) organization that operated a noncommercial broadcasting station presenting religious, educational, and public interest programs did not participate in political campaigns within the meaning of IRC 501(c)(3) when it made free air time available to all legally qualified candidates in accordance with the requirements of the Federal Communications Act of 1934. The organization made reasonable amounts of air time available without charge to all legally qualified candidates on an equal basis. Before and after each broadcast, the station made a statement indicating that the views expressed were those of the candidate, and not of the station; that the station endorsed no candidate; that the presentation was made as a public service; and that equal opportunities would be presented to all legally qualified candidates for the same public office to present their views. Rev. Rul. 74-574, 1974-2 C.B. 160.

Rev. Rul. 86-95, 1986-2 C.B. 73, describes public forums involving qualified congressional candidates that were sponsored by an IRC 501(c)(3) organization and holds that the conduct of these forums does not constitute participation or intervention in any political campaign within the meaning of IRC 501(c)(3). In that instance, the following facts and circumstances were considered:

(A) All legally qualified candidates were invited;

(B) The questions were prepared and presented by an independent nonpartisan panel;

(C) The topics discussed covered a broad range of issues of interest to the public;

(D) Each candidate had an equal opportunity to present his or her views on the issues discussed; and

(E) The moderator did not comment on the questions or otherwise make comments that implied approval or disapproval of any of the candidates.

However, the revenue ruling indicates that the presence or absence of any of these factors in similar situations is not determinative -- they would need to be considered in light of all of the surrounding factors in any particular case.

An IRC 501(c)(3) organization may hold a debate during the primary election season that is limited to legally qualified candidates for the nomination of a particular political party. In Fulani v. League of Women Voters Education Fund, 882 F.2d 621 (2d Cir. 1989), the court held that the League of Women Voters Education Fund, an IRC 501(c)(3) organization, did not violate the political campaign prohibition when it did not invite Dr. Lenora B. Fulani to participate in any of three debates that it sponsored. Two of the three debates were between candidates for the Democratic nomination for President, while the third was between candidates for the Republican nomination. Dr. Fulani was an independent and minor party candidate for the office of President. She was refused an invitation to participate because she was not seeking either the Democratic or

Republican nomination. The court noted the distinction between primary and general elections and indicated that the purpose of the debates was to educate voters about the candidates seeking the Democratic or Republican nomination. Since Dr. Fulani was not seeking either nomination, the failure to invite her to participate in the debates did not constitute participation or intervention in a political campaign.[22]

Many times, the number of legally qualified candidates for a particular office is so large that an IRC 501(c)(3) organization may determine that holding a debate to which all legally qualified candidates were invited would be impractical and would not further the educational purposes of the organization. For example, in 1996, more than 280 people declared themselves to be candidates for the office of President, while for the 2000 election, over 250 people declared themselves to be candidates for the Presidency.[23] The FEC regulations provide that an IRC 501(c)(3) organization may stage nonpartisan candidate debates, the structure of which is left to the discretion of the organization, provided that such debates include at least two candidates and are nonpartisan in that they do not promote or advance one candidate over another. 11 C.F.R. § 110.13. In determining whether an IRC 501(c)(3) organization participates or intervenes in a political campaign when it holds a candidate debate to which not all legally qualified candidates are invited, all the facts and circumstances must be considered, including the following:

(A) Whether inviting all legally qualified candidates is impractical;

(B) Whether the organization adopted reasonable, objective criteria for determining which candidates to invite;

(C) Whether the criteria were applied consistently and non-arbitrarily to all candidates; and

(D) Whether other factors, such as those discussed in Rev. Rul. 86-95, indicate that the debate was conducted in a neutral, nonpartisan manner.

This criteria was applied in TAM 96-35-003 (Apr. 19, 1996) when an organization conducted a candidate forum to which it invited the two major party candidates for the office along with up to four candidates who had reached a 15 percent share of popular support as reflected in at least one recognized credible and independent state-wide poll. The Service determined that this method ensured a meaningful field of candidates for worthwhile forums while taking into account the organization's limited space and time. Thus, when the organization conducted the forum on this

[22] Dr. Fulani and her campaign committee were denied standing to sue when they brought suits challenging the tax-exempt status of the League of Women Voters Education Fund with regard to its sponsorship of the 1992 Democratic Presidential Primary Debate (Fulani v. Bentsen, 35 F.3d 49 (2d Cir. 1994)) and of the Commission on Presidential Debates with regard to its sponsorship of the 1988 Presidential Debates (Fulani v. Brady, 935 F.2d 1324 (D.C. Cir. 1991), cert. denied, 502 U.S. 1048 (1992)) and the 1992 Presidential Debates (Fulani v. Bentsen, 862 F.Supp. 1140 (S.D.N.Y. 1994)).

[23] Of those declared candidates, only 48 in the 1996 election and 53 in the 2000 election met the FEC definition of candidate. See Section B for a discussion of the FEC definition of candidate.

basis and published the results without any candidate ratings, it did not intervene in the political campaign on behalf of or in opposition to any candidate for public office. However, when the organization published a final report of the forum which contained participants' ratings of the candidates, it did intervene in the political campaign.

**7. To what extent may campaign literature be distributed at candidate forums?**

Care must be exercised here. If all candidates appear at the forum to speak, it would be appropriate to permit all candidates to distribute campaign literature. Absent that circumstance, it would be imprudent to permit such distribution.

**8. What is the significance of whether an advocacy communication focuses on a broad or narrow set of issues?**

As noted above in question 3, Situation 4 of Rev. Rul. 78-248 holds that an organization violated the political campaign prohibition of IRC 501(c)(3) because it widely distributed candidates' voting records on a narrow range of issues of importance to the organization during an election campaign. Similarly, as also noted above, Rev. Rul. 86-95 identifies the breadth of issues as relevant in concluding that a candidate forum did not violate the political campaign prohibition. It is our understanding that many IRC 501(c)(3) organizations have interpreted these holdings to mean that groups interested in a relatively narrow issue or set of issues have less latitude in conducting what would otherwise be considered advocacy activities (as opposed to political campaign) activities during an election campaign because a narrow issue focus could be construed as *per se* evidence of a political campaign purpose.

It is important to recognize that activities such as the publication of voting records may not constitute prohibited political campaign activity for different reasons. In one situation, the activity may not violate the political campaign prohibition because it is, in fact, not related to the campaign. For example, it may actually constitute a lobbying effort. In other situations, the IRC 501(c)(3) organization is engaged in the exempt activity of encouraging people to participate in the electoral process. As discussed in G.C.M. 34233 (Dec. 3, 1969), a candidate for public office would be concerned with a broad range of issues. When the IRC 501(c)(3) organization encourages people to participate in the electoral process by providing information about individuals as candidates, it is important that the information provided address that broad range of issues and not be biased in favor or in opposition to any candidate. As previously noted, the scope of the issues is determined by the nature of the public office sought by the candidate.

With respect to other types of activities, a narrow issue focus, standing alone, is not evidence that an IRC 501(c)(3) organization's advocacy or public education efforts are biased for or against a particular candidate. (Likewise, a broad issue focus is no guarantee that an advocacy campaign necessarily lacks an impermissible electoral purpose. As noted above, voting record reports covering a fairly diverse set of specific issues can be biased if the issues are presented in a way to highlight similarities -- or dissimilarities -- between a candidate's record and the organization's known agenda.)

Therefore, the real difficulty presented by advocacy communications on a specific topic during an election campaign is not the narrow issue focus, *per se*, but the risk that the communication invites its audience to compare a candidate's positions with the organization's own views. For example, a voter guide by an environmental organization that reports votes by incumbent candidates on environmental legislation implicitly asks readers to measure candidates' records against the organization's pro-environmental position. In other words, the communication, in effect, is commenting on the candidates rather than merely addressing an issue. By contrast, an issue advertisement that focused on the same environmental issues but that did not refer to candidates, either explicitly or by the use of code words would not present the same concern. However, where the narrow issue involved is a key issue generally considered to be a high profile issue separating the candidates in a specific election, an advertisement during that election campaign would be closely scrutinized to determine whether the organization is intervening in a campaign.

To summarize, advocacy activity during an election campaign does not necessarily violate the political campaign prohibition merely because it concerns a relatively narrow issue. Consequently, IRC 501(c)(3) organizations with a narrow policy focus need not curtail their regular advocacy activities during an election campaign.

**9. What facts and circumstances would tend to show that an advocacy communication, in fact, served a bona fide nonelectoral purpose?**

While, as noted above, all facts and circumstances are relevant in determining whether the political campaign prohibition has been violated, the following kinds of facts are among those that would tend to show that an advocacy communication, in fact, served a bona fide nonelectoral purpose, such as grassroots lobbying or public education:

(1) A preexisting commitment to promoting awareness of the issue outside the election context;

(2) Statements by officers or directors (including board resolutions) indicating the organization's nonelectoral purpose and intent not to endorse or oppose any particular candidate or party;

(3) Records of research and analysis by the organization consistent with its asserted nonelectoral purpose, for example, studies showing a low level of public awareness of an issue, thus indicating a need for public education on the issue; and

(4) Where appropriate, explicit, credible public disclaimers of any endorsement (positive or negative) of any candidate during the conduct of the activity.

(5) The content of the communication being limited to the substance of the issue and avoiding any characterization of persons who favor or oppose the organization's position on the issue.

**10. What are the rules relating to IRC 501(c)(3) organizations that operate broadcast stations?**

In general, an IRC 501(c)(3) organization that operates a noncommercial broadcast station will not be considered to have participated or intervened in a political campaign if it complies with FCC regulations concerning access to air time by candidates. Noncommercial broadcast stations are prohibited from supporting or opposing candidates for public office. 47 U.S.C. § 399. They are also prohibited from broadcasting in exchange for remuneration messages or other materials that are intended to support or oppose any candidate for political office. 47 U.S.C. § 399b. An IRC 501(c)(3) organization that operates a noncommercial broadcast station is not required to permit the use of its facilities by any legally qualified candidate for any public office. However, if an organization permits a legally qualified candidate for any public office to use a broadcasting station, it must give all other legally qualified candidates for that office an equal opportunity to use the broadcasting station. For these purposes, use of the broadcasting station does not include the "[a]ppearance by a legally qualified candidate on any -- (1) bona fide newscast, (2) bona fide news interview, (3) bona fide news documentary (if the appearance of the candidate is incidental to the presentation of the subject or subjects covered by the news documentary), or (4) on-the-spot coverage of bona fide news events (including but not limited to political conventions and activities incidental thereto)." 47 U.S.C. § 315(a). In applying these rules, a broadcasting station is not required to invite all legally qualified candidates for a particular office to appear on the same program.

Rev. Rul. 74-574, 1974-2 C.B. 160, describes an IRC 501(c)(3) organization that operated a noncommercial broadcasting station presenting religious, educational, and public interest programs. In accordance with the requirements of the Federal Communications Act of 1934, the organization made reasonable amounts of air time available without charge to all legally qualified candidates on an equal basis. Before and after each broadcast, the station made a statement indicating that the views expressed were those of the candidate and not of the station; that the station endorsed no candidate; that the presentation was made as a public service; and that equal opportunities would be presented to all legally qualified candidates for the same public office to present their views. The ruling holds that the organization did not participate in political campaigns within the meaning of IRC 501(c)(3) when it made free air time available to all legally qualified candidates.

**11. What are the rules relating to colleges and universities?**

As IRC 501(c)(3) organizations, colleges and universities are prohibited from participating or intervening in any political campaign on behalf of or in opposition to a candidate for public office. In order to constitute participation or intervention in a political campaign, however, the political activity

must be that of the college or university and not the individual activity of its faculty, staff, or students.

Rev. Rul. 72-512, 1972-2 C.B. 246, describes a university that provided a political science course to acquaint students with the basic techniques of effective participation in the electoral process. The course was open to all students and consisted of several weeks of classroom work followed by two weeks in which the student was excused from class to participate in the political campaign of a candidate chosen by the student. The student was required to spend between 60 and 80 hours on campaign work and write a paper evaluating the experience. The university did not influence the choice of candidates and was reimbursed or paid for any services or facilities provided to the students for use in connection with the campaigns. The ruling holds that the university was not participating in political campaigns within the meaning of IRC 501(c)(3). Since the extent and manner of student participation in the real political process was reasonably germane to the course of instruction, the fact that the course was part of the university's curriculum and that university facilities and staff were employed in its conduct did not cause the political activity of the individual students to be attributed to the university.

Similarly, a university that provided office space and financial support for the publication of a student newspaper and made available several professors to serve as advisors to the staff was not participating in a political campaign within the meaning of IRC 501(c)(3) when the student newspaper published students' editorials on political matters. The newspaper provided training for students in various aspects of newspaper publication (including editorial policy) and was distributed primarily to students of the university. Editorial policy was determined by the student editors and not by the university or the faculty advisors. A statement on the editorial page clearly indicated that the views expressed were those of the students and not of the university. The political activities of the student editors were not attributed to the university despite the university's provision of support to the newspaper. Rev. Rul. 72-513, 1972-2 C.B. 246.

Colleges and universities frequently make facilities available to student groups and others. Whether the provision of facilities to a group for the conduct of political campaign activities will constitute participation or intervention in a political campaign by the college or university will depend upon all the facts and circumstances, including whether the facilities are provided on the same basis that the facilities are provided to other non-political groups and whether the facilities are made available on an equal basis to similar groups.

**12. In general, what are the rules pertaining to voter registration?**

An IRC 501(c)(3) organization may conduct a voter registration or get-out-the-vote drive without being considered to participate or intervene in a political campaign so long as it is conducted in a nonpartisan manner. (There are, however, special rules pertaining to private foundations -- these are discussed in the question and answer immediately below.) The determination of whether the drive is conducted in a nonpartisan manner is based upon all the facts and circumstances. Some factors that might be considered in determining whether an

IRC 501(c)(3) organization is participating or intervening in a political campaign when it conducts a voter registration or get-out-the-vote drive include the following:

(1) Whether no candidate is named or depicted or all candidates for a particular Federal office are named or depicted without favoring any candidate over any other in the voter registration or get-out-the-vote drive communication;

(2) Whether the communication names no political party except that for identifying the political party affiliation of all candidates named or depicted;

(3) Whether the communication is limited to urging acts such as voting and registering and to describing the hours and places of registration and voting;

(4) Whether all voter registration and get-out-the-vote drive services are made available without regard to the voter's political preference.

Other facts and circumstances may also be considered.[24]

**13. May an IRC 501(c)(3) organization use voter registration lists to identify unregistered voters?**

Yes, an IRC 501(c)(3) organization may use voter registration lists to identify unregistered voters. However, it should not use the list to target voters who are registered as belonging to one party or another.

**14. What are the special voter registration rules that pertain to private foundations?**

Under IRC 4945(d)(2), amounts paid or incurred by a private foundation to influence the outcome of any specific public election or to carry on, directly or indirectly, any voter registration drives are taxable expenditures subject to tax under IRC 4945, unless such amounts are paid or incurred by an organization described in IRC 4945(f).

Reg. 53.4945-3(a)(2) provides that activities considered to constitute political campaign participation or intervention include, but are not limited to --

(A) Publishing or distributing written or printed statements or making oral statements on behalf of or in opposition to a candidate;

(B) Paying salaries or expenses of campaign workers; and

[24] For one commentator's discussion of "impermissible selection criteria," see Milton Cerny, "Campaigns, Candidates and Charities: Guideposts for All Charitable Institutions," New York University's Nineteenth Conference on Tax Planning for 501(c)(3) Organizations, 5 (1991).

(C) Conducting or paying the expenses of conducting a voter registration drive limited to the geographic area covered by the campaign.

However, a private foundation may distribute amounts for voter registration drives, or make grants for voter registration drives to other organizations, and the amounts will not be considered taxable expenditures, if the following requirements, described in IRC 4945(f) and Reg. 53.4945-3(b)(1), are met:

(A) The voter registration drive expenditures must be made by an IRC 501(c)(3) organization;

(B) The organization's activities are nonpartisan, are not confined to one specific election period, and are carried on in five or more states;

(C) The organization spends at least 85 percent of its income directly for the active conduct of its exempt purpose activities;

(D) The IRC 501(c)(3) organization must receive no more than half of its support from gross investment income and at least 85 percent of its support other than gross investment income must be from exempt organizations, the general public, and governmental units, with no more than 25 percent of its support received from any one exempt organization; and

(E) The contributions to the organization for voter registration drives may not be subject to conditions that they may be used only in specified locations or only for one specific election period.

An organization that believes it can meet these requirements may seek an advance ruling to that effect. Reg. 53.4945-3(b)(4). See, e.g., PLR 92-23-050 (Mar. 10, 1992) (organization promoting voting rights of homeless meets criteria for classification as organization described in IRC 4945(f)).

**15. May an IRC 501(c)(3) organization invite candidates to speak at its events?**

An IRC 501(c)(3) organization may invite a candidate to speak at its events without being considered to have participated or intervened in a political campaign depending upon the facts and circumstances of the invitation. Candidates may be invited to speak at an event of an IRC 501(c)(3) organization either in their capacity as a candidate or in their individual capacity other than as a candidate. The facts and circumstances to be considered are dependent upon the capacity in which the candidate is invited to speak.

When a candidate is invited to speak at an event in his or her capacity as a candidate, the IRC 501(c)(3) organization may be considered to have participated or intervened in a political campaign unless it takes steps to ensure that there is no indication of support of or opposition to the

candidate by the organization. One step that an IRC 501(c)(3) organization should take is to state explicitly that it does not support or oppose the candidate when the candidate is introduced and in any communications concerning the candidate's attendance at the event. Additionally, absolutely no political fundraising should occur at the event. Other factors to be considered include those discussed in the public forum cases, although the circumstances should be reviewed more carefully when the candidates are not participating in the same event. Those factors are the following:

(A) Whether all legally qualified candidates were invited;

(B) Whether questions for the candidate were prepared and presented by an independent nonpartisan panel;

(C) Whether the topics discussed by the candidates covered a broad range of issues of interest to the public;

(D) Whether each candidate was given an equal opportunity to present his or her views on the issues discussed; and

(E) Whether a moderator commented on the questions or otherwise made comments that implied approval or disapproval of any of the candidates.

In determining whether candidates are given an equal opportunity to participate, the nature of the event to which each candidate is invited should be considered in addition to the manner of presentation. An IRC 501(c)(3) organization that invites one candidate to speak at its main banquet of the year and invites an opposing candidate to speak at a sparsely attended general meeting will likely be found to have violated the political campaign prohibition, even if the manner of presentation for both speakers is otherwise neutral. Similarly, an IRC 501(c)(3) organization that invites two opposing candidates to speak at its events with the knowledge and expectation that one will not accept the invitation because of well-known opposing viewpoints may not be considered to have provided an equal opportunity to all candidates.

Candidates may also be invited to speak at events by IRC 501(c)(3) organizations in their capacity other than as a candidate. Many candidates are public figures for reasons other than their candidacy. For instance, a number of candidates either currently hold or formerly held public office or may be experts in a non-political field. A candidate also might be a public figure as a result of a prior career, such as an acting, military, legal, or public service career. When a candidate is invited to speak at an event in a capacity other than as a candidate, it is not necessary for the IRC 501(c)(3) organization to provide equal access to all candidates. However, the IRC 501(c)(3) organization must ensure that the candidate speaks only in the other capacity and not as a candidate, that no mention is made of the individual's candidacy at the event, and that no campaign activity occurs in connection with the candidate's attendance at the event. In addition, all communications regarding the candidate's attendance at the event should clearly indicate the capacity in which the candidate is acting and should not mention the individual's candidacy. Even if the candidate does not engage in any campaign activity at the event, if the primary purpose for the invitation to the candidate is to provide public exposure for the candidate, the IRC 501(c)(3) organization may be participating or

intervening in a political campaign. If the invitation to the candidate otherwise qualifies, the mere payment of customary and usual honoraria to the candidate should not cause the IRC 501(c)(3) organization to violate the political campaign prohibition. However, when the payment of honoraria is intended to support the speaker's campaign, then the IRC 501(c)(3) organization will have violated the political campaign prohibition. The determination of whether the IRC 501(c)(3) organization has participated or intervened in a political campaign will be based on all the facts and circumstances of the particular situation.

**16. May an IRC 501(c)(3) organization violate the prohibition through its fundraising attempts?**

When the facts and circumstances indicate that an IRC 501(c)(3) organization has participated or intervened in a political campaign on behalf of or in opposition to any candidate for public office, the context in which it has intervened is irrelevant. For example, fundraising letters that intervene in a campaign constitute prohibited intervention even if the activities funded by the letters do not result in campaign intervention. TAM 96-09-007 (Dec. 6, 1995) analyzes the situation of an organization that funded voter registration drives conducted by another organization. There is no indication in the memorandum that the actual voter registration drives violated the political campaign prohibition. However, the organization sent fundraising letters that evidenced clear bias for and against particular candidates in certain closely run election campaigns. The organization argued that it had simply been trying to give a sense of urgency so as to generate more contributions. The Service determined that the organization had nevertheless intervened on behalf of and in opposition to those candidates, regardless of its motivation for doing so. See also TAM 2000-44-038 (July 24, 2000).

**17. May an IRC 501(c)(3) organization violate the prohibition through its activities on the Internet?**

When an IRC 501(c)(3) organization uses the Internet to conduct its activities, for example by sending email messages or by having a web site, it may not intervene in or participate in any political campaign on behalf of or in opposition to any candidate for public office. As with other activities of the IRC 501(c)(3) organization, the determination of whether an organization has violated the prohibition depends on all of the relevant facts and circumstances. The Service has published Announcement 2000-84, 2000-42 I.R.B. 385, requesting comments on the need for additional guidance clarifying the facts and circumstances to be considered in applying the tax laws to organizations that engage in activities on the Internet, including whether the organization has violated the political campaign prohibition.

H. Situations Involving Business Activities

**1. What are the general rules concerning business activities in relationship to the concept of participation or intervention in a political campaign?**

The question of whether an activity constitutes participation or intervention in a political campaign may also arise in the context of a business activity of the IRC 501(c)(3) organization, such as the selling or renting of mailing lists or the acceptance of paid political advertising. In this context, some of the factors to be considered in determining whether the IRC 501(c)(3) organization has engaged in prohibited political campaign activity are the following:

(A) Whether the activity is realistically available to all candidates on an equal basis;

(B) Whether the activity is available only to candidates and not to the general public; and

(C) Whether the activity is an ongoing activity of the organization or whether it is conducted for the first time for the candidate.

Ultimately, what the Service is looking for here is a track record. Is this truly the kind of activity or service that the organization has offered before and continues to offer on a nonpartisan basis? Does it truly hold itself out as providing these services to other organizations? To other candidates? Has it done so in the past? While a first time attempt to provide an activity or service of the type under discussion does not necessarily characterize it as prohibited political campaign activity, the more recent the institution of the activity or service, the lower the Service's comfort level is going to be. In addition, other facts and circumstances, such as what the relationship is between the organization and the candidate for whom the work is being performed and whether the fee charged for the services is truly set at a fair market rate, should be considered in determining whether the IRC 501(c)(3) organization has violated the political campaign prohibition.

**2. May an IRC 501(c)(3) organization sell or rent its mailing list to candidates?**

An IRC 501(c)(3) organization that regularly sells or rents its mailing list to other organizations will not violate the political campaign prohibition if it sells or rents the list to a candidate on the same terms the list is sold or rented to others, provided the list is equally available to all other candidates on the same terms. On the other hand, an IRC 501(c)(3) organization that sells or rents its mailing list to certain candidates, without making it available to all other candidates, will violate the political campaign prohibition. In determining whether the mailing list is equally available to all other candidates, it must be shown that all candidates were afforded a reasonable opportunity to acquire the list. To ensure the list is equally available to all candidates, an IRC 501(c)(3) organization should inform the candidates of the availability of the list. If the organization has never previously rented its mailing

list, the value assigned to the mailing list must be given extra scrutiny to ensure that the fee charged is a fair market rate.

**3. May an IRC 501(c)(3) organization accept paid political advertising for its publication?**

A number of IRC 501(c)(3) organizations accept paid advertising for their publications. An IRC 501(c)(3) organization that accepts paid political advertising may not be violating the political campaign prohibition if it accepts the advertisement on the same basis as other non-political advertising, provided the advertisement is identified as paid political advertising, the organization expressly states that it does not endorse the candidate, and advertising is available to all candidates on an equal basis. In determining whether advertising is available to all candidates on an equal basis, consideration should be given to the manner in which the advertising is solicited. For example, an IRC 501(c)(3) organization may not be making advertising in its publication available to all candidates on an equal basis when it expressly solicits advertising from certain candidates that support its views and merely indicates that it would accept advertising from other candidates without soliciting advertising from them or otherwise informing them that such advertising opportunities are available. The manner of presentation of the paid political advertisement also should be considered in determining whether the organization has violated the political campaign prohibition.

Although paid political advertising may not constitute participation or intervention in a political campaign, it will generate unrelated business taxable income for the IRC 501(c)(3) organization. While the Supreme Court did not expressly adopt a *per se* rule that advertising was an unrelated business, it indicated that advertising was an unrelated business except in the extremely rare case in which the organization could demonstrate that its advertising policy was explicitly designed to further its exempt purpose. United States v. American College of Physicians, 475 U.S. 834 (1986). Since political campaign activity is prohibited, the acceptance of paid political advertising would not further the exempt purpose of an IRC 501(c)(3) organization.

**4. May an IRC 501(c)(3) organization make loans to political organizations?**

An IRC 501(c)(3) organization that makes a loan to a political organization has violated the political campaign prohibition. While an IRC 501(c)(3) may invest its money and earn interest, it may not do so in a manner that constitutes participation or intervention in a political campaign. Making funds available to a political organization supports the political activities of the organization. Similarly, guaranteeing a loan to a political organization would violate the political campaign prohibition as the resources of the IRC 501(c)(3) organization would be used to support political activities. For example, see TAM 98-12-001 (Aug. 21, 1996), where the Service determined that an organization that had made a loan to a political organization had violated the political campaign prohibition of IRC 501(c)(3) and was subject to the excise tax under IRC 4955.

I. Charity/PAC Matching Programs

**1. What is a Charity/PAC matching program?**

Charity/PAC matching programs have been described in several opinions issued by the FEC. (See, e.g., FEC Advisory Opinion 1989-7, June 30, 1989.) Typically, such a program allows corporate employees to designate an IRC 501(c)(3) organization as the recipient of a contribution equal to the sum of the contributions that the employee made to the corporation's affiliated PAC in the previous year. The program generally excludes all IRC 501(c)(3) organizations that provide any benefits in return for contributions. Several FEC opinions conclude that the matching of affiliated PAC contributions with charitable donations is not a means of exchanging treasury funds for voluntary contributions, which is prohibited by 11 C.F.R. § 114.5(b). Rather, it is a permissible solicitation expense under 2 U.S.C. § 441b(b)(2). The taxation of Charity-PAC matching programs was discussed in G.C.M. 39877 (Aug. 27, 1992).

**2. Do employees recognize income from and take a charitable deduction for Charity/PAC matching program grants?**

A Charity/PAC matching program grant to an IRC 501(c)(3) organization should not be recharacterized as payment of compensation to the employee, and a subsequent payment by the employee to the IRC 501(c)(3) organization.

In Rev. Rul. 79-121, 1979-1 C.B. 61, a government official received an honorarium for making a speech to a professional society. The ruling concludes that the payment must be included in the official's gross income, even though the official requested that the payment be transferred to an IRC 501(c)(3) organization. The ruling also holds that the official, rather than the professional society, is entitled to a deduction under IRC 170 with respect to that amount.

However, under Rev. Rul. 67-137, 1967-1 C.B. 63, the right of certain employees to designate IRC 501(c)(3) organizations to which their employer will make contributions is not income to the employee. Furthermore, the contribution is deductible by the corporation to the extent provided by IRC 170. The rationale for not treating the employee's right to designate charitable recipients as compensation is that "[t]he employees are merely performing administrative duties for the corporation by suggesting specific qualified recipient organizations."

In a related area, Rev. Rul. 79-9, 1979-1 C.B. 125, which explains the acquiescence of the Service in Knott v. Commissioner, 67 T.C. 681 (1977), holds that a charitable contribution by a corporation is not taxable as a dividend to the corporation's controlling shareholders (in spite of shareholder control over the selection of the charitable donee), unless property or an economic benefit is received by the controlling shareholders or their families.

The conclusion drawn from a comparison of these rulings is that, when an IRC 501(c)(3) organization is designated to be the recipient of a payment by a person providing services for the payor, the payment is not treated as compensation unless it is in return for specific and identifiable

services, so that the payment represents a mere assignment of income. In Rev. Rul. 79-121, the amount paid to the charitable organization was clearly payment for specific and identifiable services. Therefore, the ruling was correct in treating that amount as having been paid to the service provider and then transferred to the IRC 501(c)(3) organization. However, in Rev. Rul. 67-137, the amount paid to the IRC 501(c)(3) organization by designation of the employee is not payment for services by the employee. Furthermore, the employee received no economic benefit as a result of the payment to the IRC 501(c)(3) organization.

The facts and circumstances of the Charity/PAC matching program are more similar to the circumstances of Rev. Rul. 67-137 and Rev. Rul. 79-9 than to the circumstances of Rev. Rul. 79-121. The amount paid to the IRC 501(c)(3) organization designated by the employee is not a payment for services performed by the employee. Furthermore, the employees do not receive either property or an economic benefit as a result of the contribution. See G.C.M. 39877 (Aug. 27, 1992).

**3. Is a corporation permitted to take a charitable deduction for Charity/PAC matching program grants?**

No. IRC 170(a) provides that a deduction is allowed for any charitable contribution, payment of which is made within the taxable year. "Charitable contribution" is defined as a contribution or gift to or for the use of a charitable donee. It is settled that a transfer does not qualify as a contribution or gift unless it is made without receipt or expectation of a financial or economic benefit commensurate with the money or property transferred. See, e.g., Rev. Rul. 67-246, 1967-2 C.B. 104; Rev. Rul. 76-185, 1976-1 C.B. 60. This principle has been reaffirmed by the Supreme Court in two opinions, United States v. American Bar Endowment, 477 U.S. 105 (1986), and Hernandez v. Commissioner, 490 U.S. 680 (1989). In American Bar Endowment, the Supreme Court noted that, "[a] payment of money generally cannot constitute a charitable contribution if the contributor expects a substantial benefit in return." 477 U.S. at 116. The Court applied a test in which a contribution was deductible (1) to the extent that the contribution exceeds the market value of the benefit received, and (2) if it was made with the intention of making a gift.

The same principle was applied in Hernandez. In Hernandez, the Court held that certain payments to the Church of Scientology were not eligible for a charitable deduction under IRC 170 because there was a quid pro quo for the claimed "contribution". In determining that a quid pro quo existed, the Court focused strongly on the external features of the transaction. The Court noted that looking at the external factors had the advantage of obviating the need to determine the motivations of individual taxpayers. The external factors indicating a quid pro quo included the existence of an identifiable benefit; fixed price schedules calibrated to sessions of particular length or sophistication; and the fact that the church barred the provision of benefits for free.

Applying this principle to the Charity/PAC matching program situation, the corporation making the payment to the IRC 501(c)(3) organization in return for payments to its affiliated PAC is not making a "contribution" or "gift" within the meaning of IRC 170 because it receives a substantial benefit in return. A PAC is organized to promote the interests of its sponsor. A major role of a PAC is to make contributions to political candidates, which the corporate sponsor is

prohibited by law from doing. Therefore, a contribution to a corporation's affiliated PAC is a benefit to that corporation. This benefit is received in return for the contribution the corporation agrees to make to the IRC 501(c)(3) organizations designated by the employee. Furthermore, as in Hernandez, the external features of the transaction also indicate the existence of a quid pro quo: there is an identifiable benefit, the benefit is fixed, and increases or decreases depending upon the amount of the contribution. See G.C.M. 39877 (Aug. 27, 1992).

**4. Could a Charity/PAC matching program adversely affect the IRC 501(c)(3) organization's exempt status?**

As long as the IRC 501(c)(3) organization is a passive recipient of the corporate contributions and does not play any part in the solicitation of the PAC funds, the Charity/PAC matching program will not affect its exempt status.

3. Political Organizations Under IRC 527

A. History of the Statute

(1) Situation Prior to Enactment

Prior to the enactment of IRC 527, there were no statutory provisions that dealt with the tax status of political organizations, such as political parties, campaign committees, and PACs. Rev. Proc. 68-19, 1968-1 C.B. 810, provided that political funds were generally not taxable income to the candidate on whose behalf they were collected, but it did not address the tax treatment of the political organization that collected the funds. However, as an administrative practice, the Service did not require political organizations to file returns and pay tax.

In Announcement 73-84, 1973-2 C.B. 461, the Service determined that since no IRC provisions provided for the tax-exempt status of political organizations, the investment income of political organizations, including interest, dividends, and capital gains, was subject to tax. The announcement stated that the Service would not enforce the taxation of political organizations until Congress had considered the problem. The content of Announcement 73-84 was restated in a reliance document, Rev. Rul. 74-21, 1974-1 C.B. 14, (modified and clarified in Rev. Rul. 74-475, 1974-2 C.B. 22). Rev. Rul. 74-21 noted the exemption provisions of IRC 501 and stated as follows:

> *An organization that is organized and operated exclusively to engage in activities the purpose of which is to influence the nomination or election of individuals to public office is not one of the organizations that may be exempt from the Federal income tax for purposes described in section 501. Nor is such an organization one covered under any other provision of the Code as exempt from the Federal income tax. There is no judicial decision holding that such an organization is exempt from tax.*

Rev. Rul. 74-21 then provided that political organizations would be taxed on a prospective basis on their interest, dividends, and capital gains from sales of securities. Political organizations subject to tax were required to file Form 1120.

(2) Enactment of the Statute

Congress' consideration resulted in the enactment of IRC 527 in 1975, effective for tax years beginning after December 31, 1974. This provision provides for the taxation of political organizations. The definition of a political organization in IRC 527 is similar to the description contained in Rev. Rul 74-21 -- the main differences being that the statute sets forth "primary" rather than "exclusive" organizational and operational tests and that the range of activities the organizations may seek to influence includes "selection" and "appointment" of individuals to public office as well as nominations and elections.

The thrust of IRC 527 is to subject political organizations to tax on income other than contributions, dues, and fundraising income used for political campaign purposes. For all other purposes, they are considered organizations exempt from federal income tax. IRC 527 also provides that a newsletter fund may qualify for the same tax treatment as a political organization if certain requirements are met. In addition, IRC 501(c) organizations that expend any money for political activity may be subject to tax under IRC 527.

(3) The 1981 and 1988 Amendments

In 1981, IRC 527 was amended to provide more favorable tax treatment to the principal campaign committees of candidates for Congress and, in 1988, Congress further amended IRC 527 to provide that the exempt function of a political organization includes making expenditures relating to a public office if such expenditures would be allowable as a deduction under IRC 162(a) had the officeholder made the expenditure. The 1988 amendment is effective for tax years beginning after December 31, 1986.

(4) The 2000 Amendments

In 2000, there was a great deal of concern resulting from differing treatment under the FECA and Internal Revenue laws. As discussed above, the FECA "express advocacy" standard for political activity is more limited than "participation in a political campaign" for purposes of IRC 501(c)(3). Similarly, the IRC 527 definition of political organizations as those directly or indirectly accepting contributions or making expenditures, to influence or attempt to influence the selection, nomination, election or appointment of an individual to a federal, state, or local public office or office in a political organization is broader than the FEC "express advocacy" standard. As a result, organizations were formed under IRC 527 for the purpose of influencing elections without engaging in "express advocacy" and so claimed not to be subject to FEC reporting and disclosure requirements. See Appendix III for a more detailed description of this situation.

Because of concern over a possible proliferation of organizations attempting to influence elections that claimed not to be subject to any reporting or disclosure rules under the FECA, Public

Law 106-230 was enacted on July 1, 2000. The new law, which became effective immediately, created a reporting regime for IRC 527 organizations. In order to be treated as a tax-exempt organization, the new law requires IRC 527 organizations to provide a notice of status, periodically report contributions and expenditures, and file annual information returns as well as tax returns. The new law does not affect any period prior to July 1, 2000. Prior law with respect to IRC 527 status is unchanged. In addition to creating the new forms necessary to comply with the new requirements, the Service provided guidance in the form of questions and answers concerning the application of the new reporting and disclosure requirements. Rev. Rul. 2000-49, 2000-44 I.R.B. 430 (Oct. 30, 2000). While the provisions of this ruling are addressed in the general discussion of IRC 527, the revenue ruling is separately set forth in Appendix III.

B. Tax Treatment of Political Organizations

**1. What organizations are covered by the provisions of IRC 527?**

The provisions of IRC 527 apply only to "political organizations" as defined in IRC 527(e)(1). IRC 527(e)(1) provides that "the term 'political organization' means a party, committee, association, fund, or other organization (whether or not incorporated) organized and operated primarily for the purpose of directly or indirectly accepting contributions or making expenditures, or both, for an exempt function." ("Exempt function," a term that will be discussed in greater detail below, generally means, in the context of IRC 527, influencing or attempting to influence the selection, nomination, election or appointment of an individual to a federal, state, or local public office or office in a political organization. IRC 527(e)(2).)

**2. What must an organization do to be subject to federal income tax only as a political organization under IRC 527?**

A political committee, association, fund, or other organization must meet both the organizational test of Reg. 1.527-2(a)(2) and the operational test of Reg. 1.527-2(a)(3) to be subject to tax only as a political organization under IRC 527. It may also need to file a notice of status under IRC 527(i).

**3. Does the political organization need to be established as a corporation, trust, or association?**

No, a political organization does not need to be established as a corporation, trust, or association. Under Reg. 1.527-2(a)(2), a political organization meets the organizational test if it can demonstrate that it was organized for the primary purpose of carrying on exempt function activities as defined in IRC 527. The regulation specifically states that the organization does not need to be formally chartered or established as a corporation, trust, or association. A separate bank account in which political campaign funds are deposited and disbursed only for political campaign expenses

can qualify as a political organization. Rev. Rul. 79-11, 1979-1 C.B. 207. Therefore, a political organization does not need to have any formal organizational document, such as articles of incorporation.

**4. How does a political organization without any formal organizational document satisfy the organizational test?**

Where the political organization has no formal organizational documents (for example, where it is merely a bank account), the required statement of purposes may be inferred from statements of the members of the organization at the time of its formation that they intend to operate the organization primarily to carry on exempt function activities. Reg. 1.527-2(a)(2). Federal or state initial registration filings (for example, Statement of Organization, FEC Form 1) made by the organization under applicable election laws, also can serve as evidence that the entity meets the organizational test.

**5. May an organization that is formally organized with broad and ambiguous powers meet the organizational test?**

As discussed above, the organizational test for IRC 527 is less strict than the organizational test for IRC 501(c)(3). When the purposes of the organization as set out in its organizing documents are broad and ambiguous with respect to whether the primary purpose of the organization is to carry on exempt function activities under IRC 527, all of the facts and circumstances, including oral and written statements and the actual operation of the organization, may be considered to determine the organization's primary purpose. See, e.g., FSA 2000-37-040 (June 19, 2000).

**6. How does a political organization satisfy the operational test?**

To satisfy the operational test, the organization's primary activities must be exempt function activities as defined in IRC 527. The organization may engage in activities that are not exempt function activities, but these may not be its primary activities. Reg. 1.527-2(a)(3). (The topic of the effect of nonexempt function expenditures is covered in detail below, in Section E).

**7. Must a political organization operate in accordance with normal corporate formalities?**

No. Reg. 1.527-2(a)(3) specifically provides that it is not necessary that a political organization operate in accordance with normal corporate formalities as ordinarily established in bylaws or under state law to satisfy the operational test.

**8. Must a political organization have its own Employer Identification Number ("EIN") even if it has no employees?**

A political organization must file a Form SS-4 to get an Employer Identification Number ("EIN"), even if it does not have any employees. If it does not apply for its own EIN and uses the Social Security Number or EIN of another person or organization (for example, the candidate's social security number), then its income may be wrongly attributed to the other person or organization, generating adverse tax consequences with respect to that person or organization.

**9. What is the tax treatment of a political organization under IRC 527?**

Pursuant to IRC 527(a), a political organization is exempt from federal income tax except as provided in IRC 527. The tax imposed by IRC 527 on the political organization is calculated by multiplying the political organization taxable income by the highest rate of tax specified in IRC 11(b). IRC 527(b)(1).

If the political organization has net capital gain income, then its tax is the lesser of (1) the tax calculated under IRC 527(b)(1), or (2) the sum of the tax calculated under IRC 527(b)(1) on its non-capital gain income and the capital gains tax determined under IRC 1201(a). IRC 527(b)(2).

Principal campaign committees are discussed later in this article. Their tax is determined by applying the graduated rates of IRC 11(b) rather than the highest rate.

**10. Is a political organization required to apply for recognition of tax exemption?**

No. A political organization does not need to apply for recognition of its exemption from federal income tax. On occasion, however, organizations have filed letter ruling requests for a determination that they qualify for treatment as a political organization under IRC 527. See the discussion of some recent rulings in Appendix III. No specific form is required; however, the applicable user fee must be paid. However, in order to be treated as tax-exempt, some political organizations are required to give notice to the Service that they are IRC 527 organizations. IRC 527(i).

**11. Is a political organization required to give notice that it is an IRC 527 organization?**

A political organization may be required to give notice electronically and in writing to the Service that it is a political organization described in IRC 527, in order to be treated as tax-exempt. IRC 527(i)(1)(A); Rev. Rul. 2000-49, Q&A-1. This notice must be transmitted to the Service within 24 hours of establishment of the

organization.[25] IRC 527(i); Rev. Rul. 2000-49, Q&A-8. The organization provides notice to the Service by filing Form 8871, *Political Organization Notice of Section 527 Status*. Rev. Rul. 2000-49, Q&A-2.

**12. Are all political organizations required to file the notice?**

Not all political organizations are required to file the notice. Under IRC 527(i)(5) and IRC 527(i)(6), the following three types of organizations are not required to file the Form 8871 notice:

(a) Organizations that are required to report under the FECA as a political committee;

(b) Organizations that reasonably anticipate that they will not have gross receipts of $25,000 or more for any taxable year; and

(c) Organizations described in IRC 501(c) that are subject to IRC 527(f)(1) because they have made an "exempt function" expenditure.

All other political organizations, including state and local candidate committees, are required to file the notice in order to be treated as tax-exempt. IRC 527(i)(5); IRC 527(i)(6); Rev. Rul. 2000-49, Q&A-3.

**13. Is a political organization required to file Form 8871 if it does not know whether it will have annual gross receipts of $25,000 or more for any taxable year?**

A newly established political organization is not required to file Form 8871 if it reasonably anticipates that its annual gross receipts will be less than $25,000 for its first six taxable years. IRC 527(i)(5). However, if an organization that had not previously filed Form 8871 due to this exception does, in fact, have annual gross receipts of $25,000 or more for any taxable year, in order for it to be treated as tax-exempt, it is required to file Form 8871 within 30 days of receiving $25,000. Rev. Rul. 2000-49, Q&A-4.

**14. Is an IRC 527(f)(3) separate segregated fund required to file Form 8871?**

An IRC 501(c) organization that is not prohibited from participating in political campaign activity has the option of conducting the activity itself or setting up a separate segregated fund. (See discussion of separate segregated funds of IRC 501(c) organizations below, in Part 4.) If the

[25] Organizations in existence before July 30, 2000, were required to file Form 8871 both electronically and in writing by July 31, 2000, unless they meet one of the exceptions for filing. Notice 2000-36, 2000-33 I.R.B. 173.

IRC 501(c) organization conducts the activity itself, it is subject to tax under IRC 527(f)(1) on the lesser of its investment income or the amount of its political expenditures, but it is not required to file Form 8871 pursuant to IRC 527(i)(5)(A). If the IRC 501(c) organization establishes a separate segregated fund, the fund is treated as a separate political organization under IRC 527(f)(3) and does not qualify for the exception under IRC 527(i)(5)(A). Therefore, unless it meets one of the other exceptions discussed above in question 12, the separate segregated fund is required to file Form 8871 in order to be treated as tax-exempt. IRC 527(i)(5); Rev. Rul. 2000-49, Q&A-5.

**15. Is an organization that finances both federal and non-federal election activity required to file the Form 8871 notice?**

As a general rule, any political organization (whether or not separately incorporated) that is organized and operated primarily for an exempt function under IRC 527(e)(2) must file Form 8871 unless it meets one of the exceptions discussed above in question 12, one of which is being required to report under the FECA as a political committee. An organization that finances election activity (within the meaning of the FECA) for both federal and non-federal elections may establish a political committee to receive contributions and make expenditures for both federal and non-federal election activity. In that case, the organization must register as a political committee and comply with the FECA contribution limitations and reporting requirements. 11 C.F.R. § 102.5(a)(1)(ii). Such an organization is, therefore, not required to file Form 8871.

If, however, the organization sets up separate accounts to conduct its federal election activity and its non-federal election activity, the federal account is treated as a separate political committee that is required to register and report under the FECA. 11 C.F.R. § 102.5(a)(1)(i). The treatment of the federal account as a separate committee is consistent with the organizational requirements for political organizations under IRC 527, as discussed above. Accordingly, the separate federal account is not required to file Form 8871. However, a separate non-federal account is not required to register and report under the FECA as a political committee. Therefore, in order to be treated as tax-exempt, a separate non-federal account that is described in IRC 527(e)(1) is required to file Form 8871. IRC 527(i)(6); Rev. Rul. 2000-49, Q&A-6.

**16. Are political organizations that are required to report to state or local election agencies excepted from the notice requirement?**

IRC 527(i) does not except political organizations that file reports with state or local election agencies from the notice of status requirement. Therefore, unless the political organization meets one of the exceptions discussed above in question 12, it must file Form 8871 with the Service in order to be treated as tax-exempt. Rev. Rul. 2000-49, Q&A-7.

**17. How must Form 8871 be filed?**

The Form 8871 must be filed both electronically and in writing. IRC 527(i)(1)(A). Thus, an IRC 527 organization subject to the notice requirement must file as follows:

(a) Electronically via the Internal Revenue Service Internet Web Site at www.irs.gov./polorgs, and

(b) In writing by sending a signed copy of Form 8871 to the Internal Revenue Service Center, Ogden, UT 84201.

An organization may fill in and print out the form from the IRS Web Site. Rev. Rul. 2000-49, Q&A-9.

**18. What information must be provided in the Form 8871?**

The organization must provide in the notice its name and address (including any business address, if different) and electronic mailing address; its purpose; the names and addresses of its officers, highly compensated employees, contact person, custodian of records, and members of its Board of Directors; and the name and address of, and relationship to, any related entities (within the meaning of IRC 168(h)(4)). IRC 527(i)(3); Rev. Rul. 2000-49, Q&A-11.

**19. What is a "related entity" for this purpose?**

For purposes of the Form 8871 filing requirements, an entity is a "related entity" if it is a "related entity" within the meaning of IRC 168(h)(4). Thus, it is a "related entity" under the following circumstances:

(a) The organization and that entity have (A) significant common purposes and substantial common membership or (B) substantial common direction or control (either directly or indirectly); or

(b) Either the organization or that entity owns (directly or through one or more entities) at least a 50 percent capital or profits interest in the other. For this purpose, all entities that are defined as related entities under (a) above must be treated as a single entity. Rev. Rul. 2000-49, Q&A-13.

**20. What are "highly compensated employees" for this purpose?**

Highly compensated employees for this purpose are the five employees (other than officers and directors) who are expected to have the highest annual compensation over $50,000. Compensation includes both cash and noncash amounts, whether paid currently or deferred, for the 12-month period that began with the date the organization was formed (if the organization was formed after June 30,

2000). If the organization was already in existence on June 30, 2000, it must use the accounting period that includes July 1, 2000. Rev. Rul. 2000-49, Q&A-14.

**21. What is the effect of failing to file the notice?**

Until an organization that is required to file Form 8871 in order to be tax-exempt does so, its taxable income includes its exempt function income, minus any deductions directly connected with the productions of that income. IRC 527(i)(4). As discussed below in Section E, exempt function income includes contributions, membership dues, and proceeds from political fundraising to the extent that the amounts are segregated for use in influencing nominations and for public office or similar activities.

For purposes of computing its taxable income, the organization may not deduct its exempt function expenditures because IRC 162(e) denies a deduction for political campaign expenditures. Rev. Rul. 2000-49, Q&A-15. The taxable income and tax are otherwise computed as discussed below in Section E.

**22. Are transfers to political organizations that fail to file Form 8871 subject to the gift tax?**

IRC 2501(a)(5) provides that the gift tax does not apply to transfers of money or other property to political organizations within the meaning of IRC 527(e)(1). Therefore, transfers to an organization described in IRC 527(e)(1) are not subject to the gift tax, regardless of whether the organization has filed Form 8871. Rev. Rul. 2000-49, Q&A-18.

C. Segregated Funds of Political Organizations

**1. What requirements does IRC 527 impose?**

In addition to being organized and operated primarily for exempt function purposes, the political organization must also satisfy the "segregated fund" requirement of IRC 527(c)(3).

**2. What is a "segregated fund" and what is its purpose?**

Reg. 1.527-2(b)(1) defines a "segregated fund" as "a fund which is established and maintained by a political organization or individual separate from the assets of the organization or the personal assets of the individual." The regulation further states as follows:

*The purpose of such a fund must be to receive and segregate exempt function income (and earnings on such income) for use only for an exempt function or for an activity*

*necessary to fulfill an exempt function. Accordingly, the amounts in the fund must be dedicated for use only for an exempt function. Thus expenditures for the establishment or administration of a political organization or the solicitation of political contributions may be made from the segregated fund, if necessary to fulfill an exempt function. The fund must be clearly identified and established for the purposes intended.*

**3. May a savings or checking account be a segregated fund?**

Yes, a segregated fund may be no more than a savings or checking account. This is specifically permitted by Reg. 1.527-2(b)(1).

**4. Is there a record keeping requirement for a segregated fund?**

Yes. Reg 1.527-2(b)(2) provides that the organization or individual maintaining a segregated fund must keep records that are adequate to verify receipts and disbursements of the fund and identify the exempt function activity for which each expenditure is made. Inability to substantiate that a payment was made for an exempt function purpose will result in the payment being classified as a non-exempt purpose expenditure. See, e.g., TAM 94-09-003 (Feb. 26, 1993). Conversely, showing that an expenditure was made for goods or services used exclusively for exempt purposes will establish the relationship.

TAM 93-20-002 (Jan. 14, 1993), analyzes several different types of expenditures made by a political organization. In some of these expenditures, the presence or absence of documentation was the critical factor. For example, the payment of annual membership dues for a dinner club were classified as exempt function expenditures because the organization could document that membership in the club was maintained solely for political campaign purposes. On the other hand, no part of annual fees that the organization paid for credit cards was treated as an exempt function expenditure because the organization did not pro-rate the amount of the fee based upon the use of the cards for exempt and nonexempt purposes.

D. Exempt Function Activities of Political Organizations

**1. What is the "exempt function" of a political organization?**

IRC 527(e)(2) defines "exempt function" as "the function of influencing or attempting to influence the selection, nomination, election, or appointment of any individual to any Federal, State, or local public office or office in a political organization, or the election of Presidential or

Vice-Presidential electors, whether or not such individual or electors are selected, nominated, elected, or appointed."[26]

**2. What is the meaning of "the selection process?"**

Reg. 1.527-2(c)(1) uses the term "the selection process" to encapsulate what is contemplated by "exempt function, as it pertains to the selection, nomination, election, or appointment of an individual to public office. Promoting the nomination of an individual for an elective public office in a primary election, or in a meeting or caucus of a political party, is an exempt function activity, as it is part of the selection process. Reg. 1.527-2(a)(1).[27]

**3. May payment of an office holder's expenses be an exempt function expenditure?**

For taxable years beginning after December 31, 1986, the exempt function of a political organization also includes making expenditures relating to a public office that would be allowable as a deduction under IRC 162(a) if incurred by the office holder. IRC 527(e)(2).

**4. When is an activity is part of an organization's "exempt function?"**

To determine whether an activity is part of an IRC 527 organization's exempt function, one must examine all relevant facts and circumstances to determine the relationship between the activity and the statutory definition of "exempt function." The regulations divide exempt function activities (expenditures) into "directly related expenses" (Reg. 1.527-2(c)(1)) and "indirect expenses" (Reg. 1.527-2(c)(2)).

**5. What is the meaning of the term "expenditures" for purposes of IRC 527?**

IRC 527(e)(4) provides that the term "expenditures" has the meaning given in IRC 271(b)(3). IRC 271(b)(3) definition of expenditures inclusively lists "a payment, distribution, loan, advance, deposit, or gift, of money, or anything of value and includes a contract promise or agreement to make an expenditure, whether or not legally enforceable."

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[26] Reg. 1.527-2(d) provides that the facts and circumstances of each case determine whether a particular Federal, State, or local office is a "public office," and that principles consistent with those found under Reg. 53.4946-1(g)(2) (relating to the definition of public office) will be applied.

[27] In Announcement 88-114, 1988-37 I.R.B. 26, the Service proposed to characterize attempting to influence the confirmation of a federal judge as an exempt function activity for purposes of IRC 527(e)(2) and requested comments on the proposed position. (For background, see G.C.M. 39694 (Feb. 3, 1988).) No final determination of this issue has been made.

**6. What are expenditures that are directly related to an individual's campaign for public office?**

Generally, these expenditures include anything that supports the individual's campaign. Therefore, travel, lodging, food and similar expenses of a candidate and the candidate's spouse for campaign-related travel are considered to be for an exempt function. Similarly, expenditures for attending a testimonial dinner to aid a campaign effort or expenditures for voice and speech lessons to improve a candidate's skills are for an exempt function. Reg. 1.527-2(c)(5).

**7. Must the individual be an announced candidate for a public office?**

No. Reg. 1.527-2(c)(1) provides that it is not necessary for the individual to be an announced candidate for the office; whether he or she ever becomes a candidate is, in fact, not crucial. One illustration of the application of these principles is found in PLR 82-43-142 (July 28, 1982), where an organization supporting an individual who was "testing the waters" for a possible presidential bid qualified for treatment as an IRC 527 organization, even though it was not required to file with the FEC. Another is found in TAM 93-20-002 (Jan. 14, 1993), where the organization was maintained on behalf of a former member of the U.S. House of Representatives for a possible campaign for the U.S. Senate, although the individual did not run for election during the period at issue and ultimately did not run for the Senate seat.

**8. Do the activities need to be related to the particular candidate's or office holder's own campaign?**

No. That activities need not seek to influence a particular candidate's or office holder's own campaign is illustrated by Rev. Rul. 79-12, 1979-1 C.B. 208. In that ruling, the payment of the expenses of an elected legislator to attend a political party's convention as a delegate by the legislator's campaign committee from a prior election is held to be an exempt function activity because it involves the selection process. Similarly, the payment of expenses for voter research, public opinion polls, and voter canvasses on behalf of a candidate is an exempt function activity, even when the funds expended were contributed to the organization in connection with the candidate's campaign for a different public office. Rev. Rul. 79-13, 1979-1 C.B. 208. Furthermore, expenditures for seminars and conferences that are intended to generate support for candidates with political philosophies in harmony with that of an IRC 527 organization are also for an exempt function. See Reg. 1.527-2(c)(5)(viii).

Consequently, the common practice whereby a candidate or officeholder uses funds accumulated in his or her campaign committee to make contributions to support other candidates for public office is an exempt function activity.

**9. Can election night expenditures be related to the exempt function of the organization?**

Yes. Expenditures for an election night party for political campaign workers are "an inherent part of, and the traditional public culmination of, the selection process;" therefore, these are exempt function expenditures. Rev. Rul. 87-119, 1987-2 C.B. 151, Q&A 1.

**10. May cash awards be paid to campaign workers after an election?**

Yes. Cash awards to campaign workers after an election are for an exempt function if the amount given each worker is reasonable, considering the exempt function services the worker rendered and the amount of other compensation, if any, already paid. Rev. Rul. 87-119, 1987-2 C.B. 151, Q&A 2.

**11. Can expenditures for activities between elections be related to the organization's exempt function?**

Yes. Reg. 1.527-2(c)(5)(vii) exemplifies this position in stating that expenditures by an IRC 527 organization between elections to train staff members for the next election, draft party rules, implement party reform proposals, and sponsor a party convention are for an exempt function.

**12. May payment of a salary to a candidate constitute an exempt function expenditure?**

Under the proper circumstances, payment of a salary to a candidate for the candidate's services to the campaign committee may constitute an exempt function expenditure. For example, in TAM 95-16-006 (Jan. 10, 1995), which concluded that payment to the candidate was an exempt function expenditure, the candidate worked over 80 hours per week for the campaign, performing services substantially similar to those he had performed in his pre-campaign employment. He was paid a reasonable salary for those services, amounting to 37 percent of the amount he earned from his regular employment and 60 percent of the amount he would earn if elected to public office; therefore the TAM, understandably enough, found the amount "commensurate with the services provided." The TAM also states that the amounts paid to the candidate must be treated as salary in the organization's books and records. In the situation under consideration in the TAM, while there was no written employment contract, the campaign committee appropriately reported the salary paid to the candidate as wages on Form W-2 and he reported the payments as income on his individual tax return. Accordingly, as the services he performed supported the campaign selection process, the amounts paid were reasonable, and were reported as salary, the payments constituted an exempt function expenditure.

A different situation, however, is presented when a campaign committee makes payments for the personal benefit of a candidate that are not paid as compensation and are not treated as

compensation by the organization. In that case, as will be discussed in greater detail later, the amounts paid are not exempt function expenditures, although they are considered to be income to the candidate in accordance with Reg. 1.527-5(a)(1).

**13. Could payment of a spouse's expenses be considered an exempt function activity?**

Yes, payment of a spouse's expenses in connection with a political campaign may be considered an exempt function activity so long as there is a nexus established between the spouse's activity and the exempt function of attempting to influence the selection, nomination, election or appointment of an individual to public office. Reg. 1.527-2(c)(5)(ii), Example (2). See, e.g., TAM 93-20-002 (Jan. 14, 1993).

**14. Are terminating expenditures considered to be exempt function expenditures?**

Yes, an activity that is in furtherance of the process of terminating an IRC 527 organization's existence is an exempt function activity. Reg. 1.527-2(c)(3). For example, where an organization is established to further a single campaign, its post-campaign activities of paying campaign debts, winding up the campaign, and putting its records in order are for an exempt function.

**15. Is there a time requirement imposed for the termination of a political organization?**

There is no specific time requirement imposed for terminating the activities of a political organization. Instead, since a candidate may take considerable time to decide whether he or she will run again, a rule of reason applies. As discussed below, in Section E, excess funds of a political organization must be transferred within a reasonable period of time in accordance with IRC 527(d) or held in reasonable anticipation of future exempt function use, or they will be treated as expended for the personal use of the person having control of the funds.

**16. Would sponsorship of a nonpartisan educational workshop be an exempt function activity?**

A political organization's sponsorship of a nonpartisan educational workshop that is not intended to influence or attempt to influence the selection process is not an exempt function activity. The determinative factor here is that the organization is not attempting to affect any individual's selection. Reg. 1.527-(a)(3). (For a discussion of the effect of nonexempt function expenditures, see Section E, below.)

**17. Are expenditures to support or oppose a referendum or initiative measure an exempt function activity?**

Generally, expenditures to support or oppose a referendum or initiative measure are not for an exempt function activity, since this activity generally does not further the purpose of influencing or attempting to influence the selection process. Instead, such expenditures typically constitute lobbying. The legislative history of IRC 527 treats ballot measures as outside the purview of exempt function activity. In addition to the fact that the statute refers to "selection, . . . of any individual" and the regulations refer to "the selection process", the accompanying Committee Report, S. Rep. No. 93-1357, 93d Cong. 2d Sess. 27 (1974), 1975-1 C.B. 517, 532, stated, in discussing the primary activities test, that "a qualified organization could support the enactment or defeat of a ballot proposition, as well as support or oppose a candidate, if the latter activity was not its primary activity"). (As with the previous Question and Answer, for a discussion of the effect of nonexempt function expenditures, see Section E.)

In a particular case, however, ballot measure expenditures may be for an exempt function activity, if their primary purpose is to influence or attempt to influence the selection process. For example, a legislative candidate's campaign committee may make expenditures to oppose a ballot initiative that would re-apportion legislative districts in a manner detrimental to the candidate's re-election effort. Since the expenditures are made for the primary purpose of influencing or attempting to influence the individual's election to public office, they are for an exempt function activity.

For example, in TAM 91-30-008 (Apr. 16, 1991), a gubernatorial candidate's committee funded a direct mail campaign to promote a statewide nonbinding referendum on fiscal responsibility. The material prominently displayed the candidate's name and picture and identified him as a leader on the issue. However, it did not specifically mention his candidacy since, at the time the material was mailed, he had not announced his bid for governor. The TAM concludes that the expenditures were exempt function expenditures for purposes of IRC 527(e)(2), noting that (1) an activity possibly constituting grass roots lobbying for other IRC purposes does not preclude it from being treated as an IRC 527 exempt function expenditure, and (2) in this case, the mailing both disclosed the candidate's name, picture, and political philosophy to the public and identified him as a potential candidate for governor on the issue of fiscal responsibility.

Conversely, in TAM 92-44-003 (Apr. 15, 1992), an organization was established to promote the passage of a municipal tax by referendum. The organization did not engage in any activities to attempt to influence the selection process. It was simply engaging in lobbying activities to encourage voters to approve the municipal tax rate. As a result, it did not qualify as a political organization under IRC 527.

**18. What is the proper tax status for a ballot measure committee?**

Expenditures to support or oppose initiatives, referenda, etc., generally are considered to be lobbying expenditures rather than political campaign activity. An IRC 501(c) organization may engage in lobbying activity, although there are limits on the amount of lobbying that an IRC 501(c)(3) organization may do.

Consequently, a ballot measure committee (an organization formed specifically to support or oppose an initiative or referendum measure) cannot qualify to be treated under the provisions of either IRC 527 or IRC 501(c)(3), but may, in the appropriate case, qualify for tax exempt status under other subparagraphs of IRC 501(c), for example, IRC 501(c)(4), IRC 501(c)(5), or IRC 501(c)(6). Besides otherwise meeting the requirements of the relevant subparagraph of IRC 501(c), the organization must file an annual information return (Form 990).[28]

**19. What are expenditures that are indirectly related to the exempt function?**

Expenditures that are necessary to support the directly related activities of a political organization are indirectly related to its exempt function. Examples of expenditures that are considered necessary to support the activities of a political organization are those attributable to overhead, record keeping, and fundraising. Reg. 1.527-2(c)(2).

In some cases, an organization that does not make any directly related expenditures can still qualify as a political organization under IRC 527. G.C.M. 39178 (Dec. 3, 1983), for example, describes an organization that was formed by and controlled by a political organization for the purpose of constructing, owning, and operating a building to house the headquarters of the political organization. The G.C.M. concludes that the controlled organization qualifies as a political organization because its expenditures were necessary to support the directly related activities of the controlling organization.[29]

[28] The Service is considering whether to develop an administrative procedure to expedite recognition of exempt status for organizations organized and operated solely to function as a ballot measure committee under laws administered by an elections commission or similar agency in a particular state that circumscribe the committee's functioning in a manner consistent with IRC 501(c)(4). If adopted, the procedure would make it easier for these essentially short-term organizations to satisfy the Service's need to have records regarding their existence.

[29] G.C.M. 39178 also notes that if the lessor organization rented office space in the headquarters building to an entity that was engaged in activities unrelated to the lessor's exempt function, such rent would not constitute exempt function activity. Instead, the income would be considered to be derived from a taxable trade or business.

**20. Does an organization opposing an individual's campaign for office qualify as a political organization?**

The word "influence" in IRC 527(e)(1) embraces both support and opposition. Therefore, an organization organized and operated to oppose an individual's nomination, selection, election, or appointment to public office, etc., may qualify as an IRC 527 political organization.

E. Taxable and Exempt Function Income of Political Organizations

**1. What are the general rules used to determine whether income received by a political organization is taxable?**

IRC 527(c)(1) defines "political organization taxable income" (or "taxable income") as an amount equal to the organization's gross income (excluding exempt function income) over deductions directly allowed by the Code that are directly connected with producing gross income (excluding exempt function income), computed with the modifications provided in IRC 527(c)(2). (See question 10, below, for the definition of "exempt function income.")

IRC 527(c)(2) provides three modifications:

(A) A specific deduction of $100 is provided. IRC 527(c)(2)(A). ("Newsletter funds," however, may not take the $100 deduction. "Newsletter funds" are discussed in Section H, below.)

(B) No net operating loss deduction under IRC 172 is allowed. IRC 527(c)(2)(B).

(C) The dividends received deduction and other special deductions available to taxable corporations under part VIII of subchapter B of the Code (IRC 241-249) are not allowed. IRC 527(c)(2)(C).

Note that illegal expenditures and expenditures for non-exempt function activities that directly or indirectly benefit the political organization financially are also subject to tax and must be reported as political organization taxable income on line 9 of Form 1120-POL. These two types of expenditures are discussed later in this section.

**2. Is interest on state or local bonds excluded in determining gross income?**

Yes, interest on state or local bonds, within the meaning of IRC 103, is excluded in determining gross income under IRC 527(c)(1). The definition of gross income under IRC 61 and the exclusions from gross income thus defined apply in determining gross income under IRC 527(c)(1) also.

**3. How are capital gains and losses treated?**

Special provisions apply to the taxation of capital gains. IRC 527(b)(2). If a political organization has net capital gain for a taxable year, it may, if this results in a lower tax, compute its tax on its capital gain under IRC 1201(a). IRC 527(b)(2)(A). Further, Reg. 1.527-4(b) provides that if an organization has a net capital loss, the rules of IRC 1211(a) and 1212(a) apply. Therefore, capital losses are allowed only to the extent of capital gains; furthermore, net capital losses may be carried back for three and forward for five years.

**4. When are expenses, depreciation, and similar items deductible?**

Reg. 1.527-4(c)(1) provides that expenses, depreciation, and similar items are deductible only if they satisfy both of the following requirements:

(A) They must qualify as deductions allowed under Chapter 1; and

(B) They must be "directly connected" with producing political organization taxable income.

**5. When is an item "directly connected" with producing political organization taxable income?**

To be "directly connected," a deduction item must have a proximate and primary relationship to producing taxable income and have been incurred in producing such income. Reg. 1.527-4(c)(2). If an item is attributable solely to producing taxable income, it is allowed under IRC 527. For example, Rev. Rul. 85-115, 1985-2 C.B. 172, holds that where state income taxes that a political organization paid on non-exempt function income were attributable solely to items of taxable income, they bore a "proximate and primary relationship" with producing that income. Since IRC 164 provides a deduction for such taxes in the year paid or accrued, they were allowed as a deduction under IRC 527(c)(1) in the year paid.

Whether the requisite relationship exists depends on all relevant facts and circumstances. (Compare the rules pertaining to computation of the unrelated business income tax, Reg. 1.512(a)-1(a) and (b).)

**6. What happens when facilities or personnel are used both for exempt function and taxable purposes?**

Where facilities or personnel are used both for exempt function and taxable purposes, deductions relating to that use must be allocated between exempt function and taxable income. Reg. 1.527-4(c)(3) requires that such an allocation be "on a reasonable and consistent basis." Time

spent on exempt function and taxable activities is a permitted basis for allocating salaries of personnel, for example. (Compare the principles of allocation relating to dual use of facilities or personnel set forth in Reg. 1.512(a)-1(c).)

**7. Are indirect expenses deductible?**

No, indirect expenses are not deductible. The legislative history states: "Indirect expenses (such as general administrative expenses) are not to be allowed as deductions, since it is expected that these amounts will be relatively small and eliminating these deductions will greatly simplify tax calculations." S. Rep. No. 93-1374, 93d Cong., 2d Sess. 29 (1974), 1975-1 C.B. 517, 533.

**8. When is a political organization required to file Form 1120-POL?**

Prior to 2000, a political organization was required to file Form 1120-POL if its gross income, after taking its directly connected deductions but before applying the specific $100 deduction, was greater than $100. In explaining the specific $100 deduction, the Senate Finance Committee Report states: "As a result, a political organization is not subject to tax and is not required to file a return unless its gross income exceeds its directly connected deductions by more than $100." S. Rep. No. 93-1374, 93d Cong., 2d Sess. 29 (1974), 1975-1 C.B. 517, 533. However, for taxable years beginning after June 30, 2000, a political organization will also be required to file Form 1120-POL even if it has no taxable income if its gross receipts are $25,000 or more in any taxable year. Thus, organizations that always have gross receipts of less than $25,000 and whose taxable income does not exceed the $100 specific deduction will still not be required to file the form. IRC 6012(a)(6); Rev. Rul. 2000-49, Q&A-43. However, some IRC 527 organizations file Form 1120-POL even when it is not required to start the statute of limitations period running.

**9. What are the rules regarding assessment and collection of IRC 527 taxes?**

Taxes imposed by IRC 527 are imposed under Subchapter A of the Code so all provisions of the Code and regulations that apply to Subchapter A taxes apply to assessment and collection of IRC 527 taxes. Therefore, political organizations subject to tax under IRC 527 are subject to the provisions, including penalties, for corporations generally. However, political organizations are not subject to the requirements of IRC 6655(g)(3) regarding estimated tax payments. See Reg. 1.527-8(a).

**10. What is a political organization's "exempt function income?"**

Receipts of a political organization must meet two requirements to be considered exempt function income. First, they must be amounts received by the political organization from one of the following four sources:

(1) A contribution of money or other property (IRC 527(c)(3)(A));

(2) Membership dues, fees, or assessments from a member of the political organization (IRC 527(c)(3)(B));

(3) Proceeds from a political fundraising or entertainment event or from the sale of political campaign materials, which are not received in the ordinary course of any trade or business (IRC 527(c)(3)(C)); or

(4) Proceeds from conducting bingo games that are defined in IRC 513(f)(2) (IRC 527(c)(3)(D)).

Thus, investment income, or income from a trade or business (such as renting excess office space to an unrelated organization), of a political organization is not exempt function income. Amounts received by a political organization in exchange for its promise to exercise political influence on the payor's behalf or in exchange for some other quid pro quo are likewise not exempt function income. Rev. Rul. 75-103, 1975-1 C.B. 17.

Second, receipts must be set aside in a segregated fund to be considered exempt function income. IRC 527(c)(3). Reg. 1.527-2(b)(1).

**11. What is a "contribution of money or other property?"**

Under IRC 527(e)(3) and Reg. 1.527-3(b), "contribution" has the same meaning as that given in IRC 271(b)(2) (relating to political organization bad debts). IRC 271(b)(2) provides that the term includes a gift, subscription, loan, advance, or deposit of money or anything of value, and includes a contract, promise, or agreement to make a contribution, whether or not it is legally enforceable. Generally, therefore, money or other property, whether solicited personally, by mail, or through advertising, qualifies as a contribution. Additionally, funds received under a personal income tax return "checkoff" provision (IRC 9001-9042) or similar campaign financing provisions are treated as contributions.

The legislative history indicates that exempt function income may be received indirectly as well as directly. In discussing the qualification of political organizations, the Senate Finance Committee Report states: "An organization may qualify as a political organization if it indirectly receives or expends money for campaign purposes. For example, if a national organization receives political contributions directly through local organizations, it would be indirectly accepting

contributions and would qualify under the bill." S. Rep. No. 93-1357, 93d Cong., 2nd Sess. 22 (1974), 1975-1 C.B. 517, 532 (emphasis supplied). The language of IRC 527(e)(1), in defining the "political organizations" with which IRC 527 is concerned, similarly indicates that indirect contributions are a permissible form of exempt function income. IRC 527(e)(1) defines the exempt purpose of a political organization as "directly or indirectly accepting contributions or making expenditures . . . for an exempt function" (emphasis supplied).

G.C.M. 39178 (Mar. 6, 1984), relies on the above quoted passage from the Senate Report in concluding that an organization that constructed, owned, and operated a building to house the headquarters of the IRC 527 organizations that controlled it received "exempt function income" from sharing expenses of the buildings with the related organizations. Therefore, the payments from other IRC 527 organizations for shared expenses were indirect contributions to the organization.

**12. What are "membership dues, a membership fee or assessment from a member of a political organization?"**

Reg. 1.527-3(c) provides that amounts denominated as "membership dues" or "fees" are not exempt function income if received in consideration for services, goods, or other items of value. However, filing fees that an individual pays directly or indirectly to a political party to run as a candidate in the party primary or in the general election as a party candidate, are exempt function income. For example, some states require certain office holders to pay a percentage of their first year's salary for the office to the state as a filing or "qualifying" fee or party assessment; the state then transfers the amount to the party. The transferred amount is exempt function income, as are amounts that the individual pays directly to the party as a filing fee. Id.

**13. What are "proceeds from political fundraising or entertainment events or sale of political campaign materials, which are not received in the ordinary course of any trade or business?"**

To generate exempt function income, a fundraising event must be "political in nature" and "not carried on in the ordinary course of a trade or business." Reg. 1.527-3(d)(1). Whether an event is "political in nature" depends on all relevant facts and circumstances. One factor to be considered is the extent that the event is related to a political activity aside from the organization's need for income or funds. Originally, proposed regulations would have adopted a "substantially related" test similar to the test contained in IRC 513(a) and the applicable regulations. This approach was rejected in favor of the above formulation, providing that the relationship to political activity is only one relevant factor. See T.D. 7744, 1981-1 C.B. 360, 361.

**14. When is a fundraising event is carried on "in the ordinary course of a trade or business?"**

Whether a fundraising event is carried on "in the ordinary course of a trade or business" depends on all relevant facts and circumstances. Reg. 1.527-3(d)(2). Relevant factors include the activity's frequency, the manner in which it is conducted, and the span of time over which it is carried out. (Compare Reg. 1.513-1(c)(1), which discusses when a trade or business is "regularly carried on" for purposes of applying the unrelated business income tax.) In general, proceeds from "casual, sporadic" fundraising are not received in the ordinary course of a trade or business.

Under IRC 527(c)(3)(C), proceeds from the sale of political campaign materials are exempt function income if the sale is not in the ordinary course of a trade or business (see Reg. 1.527-3(d)(2)), and is related to exempt function activity aside from the organizations need for income or funds. Reg. 1.527-3(e). Items sold may include political memorabilia, bumper stickers, buttons, hats, shirts, posters, stationery, jewelry, or cookbooks, where identified as relating to the distribution of political literature or organizing voters to vote for a candidate.

These provisions were applied in Rev. Rul. 80-103, 1980-1 C.B. 120, where a political organization sold reproductions of an original work of art, not of a political nature, that the artist had donated to it. The reproductions were sold over a period of several months through an art gallery, to which the organization had paid a fee. The sales were made solely for fundraising purposes; they were not related to the organization's political activity aside from its need for funds. Nor, because of the length of the sale period, could the sales be characterized as "casual" and "sporadic." See Reg. 1.527-3(d)(2). Therefore, Rev. Rul. 80-103 holds that the proceeds were not exempt function income.

**15. What is the meaning of "proceeds from conducting bingo games that are defined in IRC 513(f)(2)?"**

Under the relevant statutory and regulatory provisions (IRC 527(c)(3)(D), IRC 513(f)(2), and Reg. 1.513-5(d)), the bingo game must not be ordinarily conducted on a commercial basis and the activity must not violate any state law. These provisions apply solely to bingo; other games of chance, including, but not limited to, keno games, dice games, card games and lotteries, are excluded.

**16. Are proceeds from the sale of raffle tickets exempt function income?**

As noted in a memorandum dated December 1, 1999, from the Director, Exempt Organizations Division to the Regional Chief Compliance Officers, proceeds from the sale of raffle tickets are not one of the specified types of income that may be excluded from gross income of a political organization. Therefore, to be exempt function income it must meet the requirements of one of the types of income specified in IRC 527(c)(3).

**17. Are proceeds from the sale of raffle tickets contributions?**

Proceeds from the sale of raffle tickets are not contributions under IRC 527(c)(3)(A). The purchase of a raffle ticket has been viewed by the Service as the purchase of an item for value rather than as a charitable contribution. Rev. Rul. 67-246, 1967-2 C.B. 104, specifically provides that amounts paid for chances to participate in raffles, lotteries, or similar drawings or to participate in puzzle or other contests for valuable prizes are not charitable contributions. In Rev. Rul. 83-130, 1983-2 C.B. 148, the Service explained that taxpayers who purchased raffle tickets from a charity "received a chance to win a valuable prize and, therefore, received full consideration for their payments."

A similar principle was applied to raffle tickets purchased from political organizations under former IRC 24 (formerly IRC 41). Until repealed in 1986, IRC 24 allowed an individual to claim a tax credit for all "political contributions" and "newsletter fund contributions." In Rev. Rul. 72-411, 1972-2 C.B. 5, the Service determined that "an amount paid for a chance to participate in a raffle, lottery, or a similar drawing for valuable prizes is not a contribution or a gift. Such an amount is merely the purchase price of an item of value - the chance to win a valuable prize." While IRC 24 has been repealed, the principle that the purchase of a raffle ticket is the purchase price of an item for value is still valid and is applicable to political contributions under IRC 527.

**18. Are proceeds from the sale of raffle tickets membership dues, fees or assessments?**

Proceeds from the sale of raffle tickets are not membership dues, fees or assessments. As discussed in the previous question, proceeds from the sale of raffle tickets are proceeds from the purchase of an item for value. Reg. 1.527-3(c) provides that amounts denominated as "membership dues" or "fees" are not exempt function income if received in consideration for services, goods, or other items of value.

**19. Are proceeds from the sale of raffle tickets income from a political fundraising or entertainment event?**

Reg. 1.527-3(d)(1) provides that amounts received from fundraising and entertainment events are eligible for treatment as exempt function income if the events are political in nature and not carried on in the ordinary course of a trade or business. Whether an event is "political" in nature depends on all facts and circumstances. One factor that indicates an event is a political event is the extent to which the event is related to a political activity aside from the need of the organization for income or funds.

Where there is no evidence that the sale of raffle tickets is closely related to a political event, it is hard to conclude that it constitutes exempt function income. For example, where the drawing is to be held at the annual meeting of a related non-IRC 527 organization; the tickets are sold over a period of several months by telephone and through the mail; the only reference to an event is on

the back of the raffle ticket and merely indicates the date, time, and location of the drawing; the raffle tickets do not constitute admission tickets to the annual meeting; there is no expectation or requirement that ticket holders will attend the annual meeting at which the drawing occurs; and the annual meeting is not political in nature, the raffle proceeds are not exempt function income. See, e.g., TAM 98-47-006 (Aug. 11, 1998).

On the other hand, not all raffle proceeds are nonexempt function income. Proceeds of raffle tickets sold in the context of a political event may constitute exempt function income, even though the proceeds in the above example are not.

**20. Are proceeds from the sale of raffle tickets bingo income?**

Proceeds from the sale of raffle tickets do not qualify as proceeds from conducting bingo games under IRC 527(c)(3)(D). As discussed previously, IRC 527(c)(3)(D) applies solely to bingo income. Other games of chance, including raffles, are excluded.

**21. May a political organization receive exempt function income indirectly?**

Yes, a political organization may receive exempt function income indirectly. Both the legislative history and administrative interpretations accept that where an IRC 527 transfers exempt function income it has received from denominated sources to a second organization, the political contribution character of such amounts passes through so that it can be characterized as exempt function income to the second organization. See S. Rep. 1357, 93d Cong. 2d Sess. 22 (1974), 1975-1 C.B. 517, 532; G.C.M. 39178 (Mar. 6, 1984); PLR 83-16-079 (Jan. 18, 1983).

**22. What is the tax effect of using amounts from a "segregated fund" to make expenditures for non-exempt function activities?**

During a tax year, if a political organization makes an insubstantial amount of expenditures from a segregated fund for non-exempt function activities, there are no income tax consequences to the organization. Reg. 1.527-2(b)(1). The only exceptions to this general rule are when the expenditure is illegal or for an illegal activity, or the expenditure directly or indirectly financially benefits the political organization. The regulations specifically provide for those two types of expenditures to be included in the gross income of the political organization, even when insubstantial in amount. Reg. 1.527-5(a). If non-exempt function expenditures in a tax year are more than insubstantial, however, the fund is not treated as a segregated fund for that year. Reg. 1.527-2(b)(1). If the fund is not treated as a segregated fund for a tax year, then all amounts set aside in that fund during such year are included in gross income with no exclusion available for exempt function income since the receipts were not properly segregated for the year. Thus, all amounts the political organization receives during the year that it placed in that fund, less available deductions, will constitute taxable income to it.

If an organization makes more than an insubstantial amount of expenditures for non-exempt function activities from a segregated fund in more than one year, the facts and circumstances may indicate that the fund was never a segregated fund. Reg. 1.527-2(b)(1). In that case, the exclusion from gross income for exempt function income would not be available for the political organization in prior years.

**23. What amount of expenditures is more than insubstantial?**

The Service has not developed a bright-line test for determining what is a more than an insubstantial amount of non-exempt function expenditures. Law developed under the "no substantial part" test that pertains to lobbying by charitable organizations provides some guidance, however.

One frequently cited decision held that lobbying activities constituting five percent of total activities of an organization were not substantial. Seasongood v. Commissioner, 227 F.2d 907 (6th Cir. 1955). In Haswell v. United States, 500 F.2d 1133 (Ct. Cl. 1974), cert. denied, 419 U.S. 1107 (1975), the court held that lobbying activities constituting between 16.6 percent and 20.5 percent of total expenditures were substantial. (The figures varied with the years involved and the method of calculation.)

**24. What effect do substantial non-exempt function expenditures have on the exempt status of a political organization?**

As noted above, IRC 527(e)(1) defines a political organization as being organized and operated primarily for the purpose of directly or indirectly accepting contributions or making expenditures, or both, for an exempt function, and Reg. 1.527-2(a)(3) provides that a political organization may engage in non-exempt function activity, provided the activity is not primary. Therefore, the demise of a political organization's segregated fund because of substantial non-exempt function expenditures would not necessarily have an adverse tax effect on any other segregated funds maintained by the political organization or on the political organization's status under IRC 527 (assuming it had income in other segregated funds), so long as, after taking all facts and circumstances into account, the political organization's exempt function activities were primary. If the political organization's non-exempt function activities were primary, however, it would lose its tax status under IRC 527.

**25. How is an organization taxed that loses its exempt status under IRC 527?**

An organization that loses its exempt status under IRC 527 is subject to federal income tax under general tax principles. Depending on the organization's structure, it may be subject to tax as a corporation (see Rev. Rul. 74-21, 1974-1 C.B. 14), or as a trust (see Rev. Rul. 74-23, 1974-1 C.B. 17). However, a political organization that is not

treated as tax-exempt because it failed to file a required Form 8871 will be taxed in accordance with IRC 527(i)(4). (See the discussion in Section B, above.)

**26. What is the tax effect of making expenditures that are illegal?**

Expenditures that are illegal, or for an activity that is judicially determined to be illegal, are never considered to be for exempt function activities. Reg. 1.527-2(c)(4). Thus, if such expenditures are more than insubstantial, the fund will not be considered a segregated fund for the taxable year. In addition, the amount of such expenditures is included in the political organization's taxable income for the year in which they are made, even where the amount of the organization's expenditures for non-exempt function activities is not substantial (so as to cause all receipts of that segregated fund during relevant periods not to be exempt function income). Reg. 1.527-5(a)(2). However, amounts will not be included in political organization taxable income more than once (that is, because they were not properly segregated and because they were expended illegally or for an illegal activity). The prohibition on illegal expenditures is intended to apply to criminal activities and not to violations of civil law, regulation, or administrative rule.

It should be noted Reg. 1.527-5(a)(2) specifically provides that expenses incurred in defense of suits against the political organization are not treated as taxable income to it. Similarly, voluntary reimbursement to the participants in the (alleged) illegal activity for similar expenses incurred by them are not taxable to the organization if it can demonstrate that such payments do not constitute a part of the inducement to engage in the illegal activity or part of the agreed upon compensation therefor. However, if the organization entered into an agreement with the participants to defray such expenses as part of the inducement, such payments would be treated as an expenditure for an illegal activity.

**27. What is the tax effect of making non-exempt function expenditures that financially benefit the political organization?**

Expenditures for non-exempt function activities that directly or indirectly financially benefit a political organization (for example, the purchase of an office building for the production of income), will result in the fund not being considered a segregated fund for the taxable year if such expenditures are more than insubstantial. In addition, the amount of such expenditures is included in the political organization's taxable income for the year in which they are made, even where the amount of the organization's expenditures for non-exempt function activities is not substantial (so as to cause all amounts received during relevant periods not to be exempt function income). Reg. 1.527-5(a)(1). Amounts will not be included in political organization taxable income more than once, however (that is, because they were not properly segregated and because they were expended for an activity financially benefiting the organization).

Reg. 1.527-5(a)(1) contains specific examples of when a political organization's expenditures on facilities or equipment will and will not be included in its taxable income. It provides that if the organization expends exempt function income for making an improvement or addition to its facilities, or for equipment, that is not necessary for or used in carrying out an exempt function, the amount of the expenditure will be included in the political organization's taxable income. It proceeds to state, however, that if a political organization expends exempt function income to make ordinary and necessary repairs on the facilities it uses in conducting its exempt function, such amounts will not be included in its taxable income.

**28. How are loans made by a political organization treated?**

Loans made by a political organization are "expenditures" of the organization. IRC 217(b)(3). The treatment of a particular loan depends on whether it is for an exempt function activity.

**29. Are transfers to other organizations allowable?**

Yes, transfers to other organizations may be allowable exempt function expenditures. IRC 527(d) specifies certain situations where a political organization's transfers to other organizations are not treated as amounts expended for the personal use of the candidate or any other person; instead, they are treated as exempt function expenditures. The allowable transfers are as follows:

(A) Contributions to or for the use of another IRC 527 political organization or newsletter fund;

(B) Contributions to or for the use of any tax-exempt public charity that is described in IRC 509(a)(1) or (2); and

(C) Deposits made to the general fund of the Treasury or the general fund of any State or local government.

IRC 527(d) specifically provides, however, that no deduction will be allowed for transferred amounts. See also Reg. 1.527-5(b). Furthermore, this provision does not apply to any amount transferred in satisfaction of a liability of the candidate or other person. For example, an amount paid to the general fund of the U.S. Treasury in satisfaction of the candidate's tax liability will be included in the candidate's gross income and is not an exempt function expenditure. Reg. 1.527-5(a)(1).

**30. What is "to or for the use of" a tax-exempt public charity?**

As discussed above, IRC 527(d)(2) provides that amounts contributed "to or for the use of" an organization exempt from tax under IRC 501(a) and described in IRC 509(a)(1) or 509(a)(2) will not be considered diverted for the personal benefit

of any individual. See also Reg. 1.527-5(b)(2). IRC 509(a) provides that an organization described in IRC 501(c)(3) is a private foundation unless it meets one of four tests, including those set forth in IRC 509(a)(1) and 509(a)(2).

For example, in PLR 94-25-032, a private foundation requested a ruling that contributions to it from campaign committees would be considered "for the use of" organizations meeting the requirements of IRC 527(d)(2). As a private foundation, it did not meet these requirements itself. However, it had been formed to make contributions to colleges or universities to fund scholarships for students who need or deserve monetary assistance to further their education and to make contributions to other organizations recognized as public charities under IRC 501(c)(3) and IRC 509(a)(1). Similarly, upon dissolution, its assets would be distributed to an organization described in IRC 501(c)(3) and IRC 509(a)(1). Under the law of the state in which the private foundation was incorporated, it was considered a charitable trust and the Attorney General, as well as any other person with a sufficient special interest under a liberal standing rule, may bring an action to enforce proper administration of the charitable trust.

Under IRC 170(c), a deduction is allowed for contributions "to or for the use of" certain enumerated organizations, including charitable organizations. In that context, the Supreme Court has stated that "a gift or contribution is 'for the use of' a qualified organization when it is held in a legally enforceable trust for the qualified organization or in a similar legal arrangement." Davis v. United States, 495 U.S. 472, 485 (1990). The Court stated further:

> *A defining characteristic of a trust arrangement is that the beneficiary has the legal power to enforce the trustee's duty to comply with the terms of the trust. See, e.g., 3 W. Fratcher, Scott on Trusts § 200 (4th ed. 1988); 1 Restatement of Trusts § 200 (1935). A qualified beneficiary of a bona fide trust for charitable purposes would have both the incentive and legal authority to ensure that donated funds are properly used. If the trust contributes funds to a range of charitable organizations so that no single beneficiary could enforce its terms, the trustee's duty can be enforced by the Attorney General under the laws of most States. See 4A W. Fratcher, Scott on Trusts § 391 (4th ed. 1989); G. Bogert, Trusts and Trustees § 411 (2d ed. 1977).* Id. at 483.

Applying these principles to the identical language in IRC 527(d)(2), PLR 94-25-032 held that a contribution by a political organization will be considered "for the use of" an organization meeting the requirements of IRC 527(d)(2) if it is held in a legally enforceable trust or similar legal arrangement. In this situation, although the organization may contribute its funds to a number of organizations, it is legally required to distribute it only to organizations described in IRC 501(c)(3) and IRC 509(a)(1); that requirement may be enforced by the Attorney General of the state in which the private foundation was incorporated. Accordingly, contributions to that private foundation will be considered "for the use of" organizations described in IRC 527(d)(2).

Although contributions to that private foundation would qualify under IRC 527(d)(2), contributions to many private foundations would not. In PLR 94-25-032, the organization's activities were strictly limited to making contributions to organizations that qualified under IRC 527(d)(2). In many cases, private foundations are not so limited. They frequently carry on their own charitable

programs or they may be formed to contribute to IRC 501(c)(3) organizations, without regard to the their private foundation status. In addition, whether particular provisions in a foundation's governing instrument create an enforceable charitable trust or similar arrangement is a question of state law; provisions such as those present in PLR 94-25-032 might not create an enforceable trust arrangement under the laws of a different state. In those cases, contributions to the private foundation would not qualify as "for the use of" organizations meeting the requirements of IRC 527(d)(2).

Under the principles discussed in this ruling, a contribution by a political organization to an IRC 501(c)(3) organization that is not a private foundation because it is described in IRC 509(a)(3) may sometimes be considered "for the use of" an organization meeting the requirements of IRC 527(d)(2). An IRC 509(a)(3) organization is required to operate for the exclusive benefit of one or more specified IRC 509(a)(1) or IRC 509(a)(2) organizations and must be operated, supervised, or controlled by or in connection with one or more of those organizations. If, under state law, such an organization is considered a charitable trust or similar arrangement, the amounts contributed to the IRC 509(a)(3) organization would qualify under IRC 527(d)(2).

**31. When will an individual receive gross income as a result of expenditures by a political organization?**

As indicated in the response to the previous question, the general principle here is that amounts expended by the political organization for an exempt function, as defined in IRC 527(e)(2), are not income to the individual on whose behalf such expenditures are made. Thus, for example, a political organization may reimburse an individual's actual expenses for travel to political fundraising events; such amounts are expenditures for an exempt function and therefore are not income to the individual. Reg. 1.527-2(c)(5)(i) and 5(a)(1).

The opposite result is reached, however, where a political organization makes expenditures for non-exempt function activities, using amounts in its segregated fund, to an individual for his or her personal use. In that case, the individual on whose behalf the expenditures are made will be in receipt of income, in the amount of the expenditure, for the taxable year in which the amount is received.

**32. What determines whether a payment is made for "personal use?"**

Reg. 1.527-5(a)(1) provides that amounts are expended for the personal use of an individual where a direct or indirect financial benefit accrues to such individual. "Personal use" is not limited to direct financial benefit, but includes (for example) the benefit an individual derives from directing funds to a third party. See Estate of Geiger v. Commissioner, 352 F.2d 221 (8th Cir. 1965).

Note that whether an individual benefiting from such expenditures receives taxable income depends on general income tax principles, that is, whether such amounts are includable in the

individual's gross income pursuant to IRC 61 and whether an exclusion (for example, as a gift under IRC 102), is available for such amounts.

**33. Is repayment of a loan from a candidate to a political organization included in the candidate's gross income?**

If the loan is properly documented and otherwise treated as a loan, repayment of the loan will not be treated as an expenditure by the political organization for the benefit of the candidate, and the repayment will not be includable in the candidate's gross income under IRC 527(d). See, e.g., PLR 81-17-207 (Jan. 30, 1981). (The PLR also concludes that the political organization may pay interest on the loan from the candidate, and such interest will be includable in the candidate's gross income.)

**34. How are excess campaign funds treated?**

Reg. 1.527-5(c)(1) provides that excess campaign funds (funds controlled by a political organization or other person after a campaign) are treated as expended for the personal use of the person having control of the ultimate use of the funds except to the extent that the political organization does either of the following:

(A) The excess funds are transferred within a reasonable period of time in accordance with IRC 527(d) (contributed to or for the use of another IRC 527 political organization or newsletter fund; contributed to or for the use of an IRC 509(a)(1) or (2) public charity; or deposited in the general fund of the U.S. Treasury or in the general fund of a State or local government); or

(B) The excess funds are held in reasonable anticipation of use by the political organization for future exempt functions.

Therefore, a political organization's expenditure of excess campaign funds from one campaign to pay expenses of the candidate's campaign for a second office are for an exempt function and do not result in income to the candidate. Rev. Rul. 79-13, 1979-1 C.B. 208. Similarly, an elected legislator may expend surplus campaign funds to defray expenses of attending a political convention, an exempt function activity, without receiving taxable income. Rev. Rul. 79-12, 1979-1 C.B. 208.

Reg. 1.527-5(c)(2) provides that if the individual controlling the funds dies, the income will be included as part of the decedent's gross estate unless the funds are transferred to the organizations or funds described above within a reasonable period of time or unless the decedent provided for such a transfer.

**35. What is a "reasonable period of time for transfer of excess campaign funds" or "reasonable anticipation of use for future exempt functions?"**

The determination of what is a reasonable period of time for transfer of excess campaign funds or reasonable anticipation of use for future exempt functions is based on the facts and circumstances of the particular situation. Some of the facts and circumstances to be considered are (1) whether there are outstanding expenses remaining from the previous election, (2) whether the candidate has announced an intention to seek election in the future, and (3) the uses to which the excess campaign funds are currently being put. For example, a reasonable period of time for a campaign committee to retain excess campaign funds used to service a debt to an unrelated third party would be the period of debt service. Similarly, a reasonable anticipation of use for future exempt functions exists when the candidate has announced an intention to seek reelection. On the other hand, excess campaign funds that are unreasonably retained when there are no outstanding debts from a previous election and the candidate has announced an intention not to seek election to public office will be treated as expended for the personal use of the person having control of the ultimate use of the funds. Reg. 1.527-5(c)(1).

**36. What is the tax effect of using funds, other than segregated funds, to make non-exempt function expenditures?**

Non-segregated funds are included in the organization's taxable income when received. IRC 527(c)(1). The only additional tax effect resulting from making an expenditure of non-segregated funds may be a deduction from taxable income (where a deduction is available under IRC 527(c)).

F. Reporting and Disclosure Requirements

(1) Periodic Reporting Requirements

**1. What are the periodic reporting requirements imposed upon political organizations?**

A political organization may be required to periodically report on Form 8872 contributions to the organization and expenditures made by the organization. IRC 527(j); Rev. Rul. 2000-49, Q&A-21 & Q&A-22.

**2. What triggers the requirement to file periodic reports on Form 8872?**

Accepting contributions or making expenditures for an exempt function under IRC 527 during a calendar year triggers the requirement to file periodic reports on Form 8872, beginning with the first month or quarter in which the political organization accepts contributions or makes

expenditures. IRC 527(j)(2). However, only those political organizations that accept contributions or make expenditures with respect to a particular election for federal office (as defined in IRC 527(j)(6)) are subject to the requirement to file pre-election reports for that election. IRC 527(j)(2)(A)(i)(II); Rev. Rul. 2000-49, Q&A-23.

**3. Are all political organizations required to file periodic reports on Form 8872?**

No, IRC 527(j)(5) provides that some organizations are not subject to the Form 8872 periodic reporting requirement. The organizations excepted from these filing requirements are as follows:

(a) Organizations excepted from the requirement to file a Form 8871;

(b) State and local candidate committees; and

(c) State and local committees of political parties.

All other political organizations, including state and local political action committees, are subject to the reporting requirements of IRC 527(j), even if they file reports with state or local election agencies. Rev. Rul. 2000-49, Q&A-24.

**4. Must a state or local candidate or officeholder organize a formal committee?**

No, as discussed above in Section B, IRC 527 does not require organizations to have formal organizational documents. Therefore, a candidate or officeholder does not need to organize a formal committee to qualify for the exception under IRC 527(j)(5) for committees of state or local candidates. Rev. Rul. 2000-49, Q&A-25.

**5. Must purely state and local political organizations file Form 8872?**

Yes, unless the organization meets one of the exceptions discussed above in question 3. Except as provided above, political organizations that engage in exempt function activities solely with respect to elections for state or local offices are not excepted from the Form 8872 filing requirements. Although the timing of the reports is based upon federal elections, the requirement to file the reports is based on accepting contributions or making expenditures for an exempt function under IRC 527(e)(2), which includes attempting to influence state or local elections. Therefore, unless a political organization meets one of the exceptions discussed above, it is subject to the requirement of filing Form 8872 with the Service. Rev. Rul. 2000-49, Q&A-26.

**6. What if an organization receives $25,000 or more in any taxable year?**

As discussed above, organizations that reasonably anticipate that they will not receive $25,000 or more in annual gross receipts are not required to file Form 8872. A political organization that does, in fact, receive $25,000 in any taxable year no longer qualifies for that exception. Therefore, the organization must begin filing Form 8872 unless it meets one of the other exceptions discussed above. IRC 527(j)(5). The organization must file, within 30 days of receiving $25,000, any Form 8872 that would otherwise have been due during the calendar year prior to that date. Rev. Rul. 2000-49, Q&A-27.

**7. How often must the periodic reports be filed?**

Political organizations subject to the periodic reporting requirement may choose to file on a monthly basis or on a schedule that depends upon whether it is an election year or non-election year, but it must file on the same schedule basis for the entire calendar year. Rev. Rul. 2000-49, Q&A-28.

**8. What is an election year and non-election year for purposes of determining the due dates for filing Form 8872?**

An election year is any year in which a regularly scheduled general election for federal office is held, i.e., any even-numbered year. A non-election year is therefore any odd-numbered year.

**9. When must the periodic reports be filed if the organization files monthly?**

Political organizations that choose to file monthly must file Form 8872 reports on the 20th day after the end of the month and shall be complete as of the last day of the month. However, in any year in which a regularly scheduled general election is held (even-numbered years), these organizations shall not file the reports regularly due in November and December (i.e., the monthly reports for October and November). Instead, the organizations must file a Form 8872 report twelve days before the general election (or fifteen days before if posted by registered or certified mail) that contains information through the twentieth day before the general election. These organizations must also file a report no more than thirty days after the general election which shall contain information through the twentieth day after the election. The year end report is due by January 31 of the following year. IRC 527(j)(2)(B); Rev. Rul. 2000-49, Q&A-30 & Q&A-31.

**10. When must the periodic reports be filed if the organization does not file monthly?**

Political organizations that choose not to file monthly must file semi-annual reports in non-election years (odd-numbered years). These reports are due on July 31 for the first half of the year and, for the second half of the year, on January 31 of the following year. Rev. Rul. 2000-49, Q&A-32. In an election year (even-numbered years), these organizations must file quarterly reports due on the 15th day after the last day of the quarter, except that the return for the final quarter shall be due on January 31 of the following year. In addition, the organizations must file pre-election reports with respect to any election for which the organization receives a contribution or makes an expenditure. These reports are due the 12th day before the election (the 15th day before if posted by registered or certified mail) and must contain information through the twentieth day before the election. The organizations must also file a post-general election report due thirty days after the general election and containing information through the twentieth day after the election. IRC 527(j)(2)(A); Rev. Rul. 2000-49, Q&A-33.

**11. What is an election for these purposes?**

For purposes of determining what is an election year and what elections trigger the pre-election and post-general election reports, an "election" is a general, special, primary, or runoff election for a Federal office; a convention or caucus of a political party with authority to nominate a candidate for Federal office; a primary election to select delegates to a national nominating convention of a political party; or a primary election to express a preference for the nomination of individuals for election to the office of President. IRC 527(j)(6). Thus, an election for these reporting requirements does not include elections that are purely state or local elections. When an election involves both candidates for federal office and candidates for state or local offices, it is an election for purposes of the reporting deadlines, but only those organizations that make contributions or expenditures with respect to the candidates for federal office are required to file the pre-election reports for those elections. IRC 527(j)(2)(A)(i)(II). However, all periodic reports filed must contain information about the contributions and expenditures within the reporting period, regardless of whether they were accepted or made with respect to candidates for federal, state or local office. IRC 527(j); Rev. Rul. 2000-49, Q&A-34.

**12. What is a general election?**

A general election an election for Federal office held in even numbered years on the Tuesday following the first Monday in November or an election held to fill a vacancy in a Federal office (i.e., a special election) that is intended to result in the final selection of a single individual to the office at stake. See 11 C.F.R. § 100.2(b). Rev. Rul. 2000-49, Q&A-35.

**13. How will "election" under § 527(j)(6) be interpreted?**

The definition of "election" under IRC 527(j)(6) is virtually identical to the definition of "election" under the FECA (2 U.S.C. § 431(1)). Organizations may rely on FEC interpretations of the FECA definition in the absence of further guidance from the Service. The FEC publishes information concerning the filing requirements under the FECA and the dates for filing those reports, including information on the dates of elections, on its Web Site at http://www.fec.gov/pages/report.htm. Rev. Rul. 2000-49, Q&A-36.

**14. What must the reports contain?**

The reports must include the name, address, and (if an individual) the occupation and employer, of any person to whom expenditures are made that aggregate $500 or more in a calendar year and the amount of such expenditure. The reports must also include the name, address, and (if an individual) the occupation and employer, of any person that contributes in the aggregate $200 or more in a calendar year and the amount of such contribution. IRC 527(j)(3). However, an organization is not required to report independent expenditures, as defined in § 301 of the FECA. IRC 527(j)(5)(E). This reporting requirement only applies to contributions received or expenditures made after July 1, 2000, that are not made or received pursuant to binding contracts entered into before July 2, 2000. Rev. Rul. 2000-49, Q&A-37.

**15. What is an independent expenditure under § 301 of the FECA?**

An independent expenditure is an expenditure by a person expressly advocating the election or defeat of a clearly identified candidate for federal office which is made without cooperation or consultation with any candidate for federal office, or any authorized committee or agent of such candidate, and which is not made in concert with, or at the request or suggestion of, any candidate for federal office, or authorized committee or agent of such candidate. See 2 U.S.C. § 431(17). Rev. Rul. 2000-49, Q&A-38.

**16. Where is the Form 8872 filed?**

The report is filed by sending a signed copy of Form 8872 to the Internal Revenue Service Center, Ogden, UT 84201. The form must be signed by an official authorized by the organization to sign the report. Rev. Rul. 2000-49, Q&A-39. Alternatively, the organization may file Form 8872 electronically instead, via the IRS Web Site at www.irs.gov/polorgs. Political organizations that have filed Form 8871 both electronically and in writing will receive a user ID and password to enable them to file Form 8872 electronically.[30]

[30] Because the user ID and password are sent to all political organizations that file Form 8871 both electronically and in writing, some organizations that are not required to file Form 8872 will receive a user ID and password. Therefore, an organization should not assume that it is required to file Form 8872 merely because it has received a user

Organizations that file Form 8872 electronically are not required to send a copy to Ogden, UT. See News Release IR-2000-80 (Nov. 14, 2000).

**17. What if a political organization does not file the required Form 8872?**

An organization that filed Form 8871 and does not file the required Form 8872, or which fails to include the information required on the Form 8872, is subject to the payment of an amount equal to the amount not disclosed on return multiplied by the highest corporate tax rate, currently 35 percent. IRC 527(j)(1); Rev. Rul. 2000-49, Q&A-40.

(2) Annual Return Requirements

**1. Are political organizations required to file annual income tax returns?**

Political organizations that have taxable income in excess of the $100 specific deduction allowed under IRC 527 are required to file an annual income tax return, the Form 1120-POL. In addition, for taxable years beginning after June 30, 2000, political organizations that have $25,000 or more in gross receipts for the taxable year are required to file the Form 1120-POL, without regard to whether they have taxable income. IRC 501(c) organizations that are subject to tax under IRC 527(f)(1) are also required to file the Form 1120-POL. IRC 6012(a)(6); Rev. Rul. 2000-49, Q&A-43. The return is due on or before the 15th day of the third month after the close of the organization's fiscal year. IRC 6072(b); Rev. Rul. 2000-49, Q&A-44. Thus, for a calendar year taxpayer, the return is due on March 15 of the following year. Some organizations that do not have taxable income or gross receipts of $25,000 or more during a tax year nevertheless file a Form 1120-POL in order to start the statute of limitations period running.

**2. Are political organizations required to file an annual information return?**

Tax-exempt political organizations that are required under IRC 6012(a)(6) to file an income tax return are also required to file Form 990 for taxable years beginning after June 30, 2000. IRC 6033(g). Tax-exempt political organizations with gross receipts less than $100,000 and assets of less than $250,000 may file Form 990-EZ. Tax-exempt political organizations with gross receipts of less than $25,000 are not required to file Form 990 or Form 990-EZ. Rev. Rul. 2000-49, Q&A-45. The return is due on or before the 15th day of the fifth month after the close of the organization's fiscal year. Thus, for a calendar year taxpayer, Form 990 is due on May 15 of the following year. Rev. Rul. 2000-49, Q&A-46.

ID and password from the Service.

**3. What if the political organization fails to file Form 1120-POL or Form 990?**

A political organization that fails to file a required Form 1120-POL or Form 990 or fails to include required information on those returns is subject to a penalty of $20 per day for every day such failure continues. The maximum penalty imposed with regarding any one return is the lesser of $10,000 or 5 percent of the gross receipts of the organization for the year. In the case of an organization having gross receipts exceeding $1,000,000 for any year, the penalty is increased to $100 per day with a maximum penalty of $50,000. IRC 6652(c)(1)(A); Rev. Rul. 2000-49, Q&A-47.

(3) Public Disclosure Requirements

**1. Are the reports, returns, and notice of status filed by a political organization publicly available?**

Yes, Form 8871 (including any supporting papers), and any letter or other document the Internal Revenue Service issues with regard to Form 8871, will be open to public inspection at the Service's National Office. IRC 6104(a); Rev. Rul. 2000-49, Q&A-19. Form 8872 will be made available for public inspection by the Service. IRC 6104(b) and IRC 6104(d)(6); Rev. Rul. 2000-49, Q&A-41. Form 1120-POL and Form 990 for taxable years beginning after June 30, 2000 will be made available for public inspection by the Service. IRC 6104(b); Rev. Rul. 2000-49, Q&A-48. Contributor information must be disclosed to the public. IRC 6104(b) and IRC 6104(d)(3)(A).

In addition, the organization is required to make a copy of these materials available for public inspection during regular business hours at the organization's principal office and at each of its regional or district offices having at least three paid employees by the public in the same manner as applications for exemption and annual information returns of IRC 501(c) organizations are made available. It must also provide a copy to any person requesting a copy in person or in writing without charge other than a reasonable charge for reproduction and postage in the same manner that IRC 501(c) organizations provide copies of their applications and annual returns. IRC 6104(d)(1); Rev. Rul. 2000-49, Q&A-19, Q&A-41 & Q&A-48. The organization only needs to make its Form 1120-POL and Form 990 available for a three-year period after filing. IRC 6104(d)(2).

**2. What is the penalty for failure to comply with the public inspection requirement?**

A penalty of $20 per day will be imposed on any person with a duty to comply with the public inspection requirement for each day a failure to comply with the requirement to make the Form 8871 available continues. IRC 6652(c)(1)(D); Rev. Rul. 2000-49, Q&A-20. Similarly, a penalty of $20 per day will be imposed on any person with a duty to comply with the public inspection requirement for each day a failure to comply with the requirement to make the Form 8872, Form 1120-POL or Form 990 continues.

The maximum penalty that may be incurred for any failure to disclose any one report is $10,000. IRC 6652(c)(1)(C); Rev. Rul. 2000-49, Q&A-42 & Q&A-49.

**3. Is the Service required to provide a list of organizations that have filed Form 8871?**

Yes. Under IRC 6104(d), the Service is required to provide upon the Internet a list of organizations that have filed the notice, including the name, address, electronic mailing address, the contact person, and the custodian of records within five business days of receiving the notice from political organizations. This listing is available on the IRS Web Site at www.irs.gov/polorgs under "Notices and Reports," where the Service has posted all filed Forms 8871 and Forms 8872.

**4. Are filed forms posted on the IRS Web Site considered "widely available"?**

As discussed above, the Service is currently posting all filed Forms 8871 and Forms 8872 on the IRS Web Site at www.irs.gov/polorgs. As long as the organization provides the IRS Web Site address to the person making the request for copies of the forms, the forms are considered widely available under Reg. 301.6104(d)-3. Rev. Rul. 2000-49, Q&A-19 & Q&A-41.

G. Special Rules for Principal Campaign Committees

**1. What is a "principal campaign committee?"**

For purposes of IRC 527, a "principal campaign committee" is the political campaign committee designated by a candidate for Congress as the candidate's principal campaign committee for purposes of § 302(e) of the FECA (2 U.S.C. § 432(e)). IRC 527(h)(2)(A). Therefore, principal campaign committees of candidates for public offices other than those in the United States Congress cannot qualify for treatment as a "principal campaign committee" under IRC 527.

**2. What are the rules relating to designation of a principal campaign committee?**

A candidate for Congress may only designate one committee as a principal campaign committee at any time and, unless the candidate has only one campaign committee, must make the designation in the manner specified in the regulations. IRC 527(h)(2)(B). No political committee may be designated as the principal campaign committee of more than one candidate for Congress and no committee that supports or has supported more than one candidate for Congress may be designated as a principal campaign committee. Reg. 1.527-9(a).

Designation is made by attaching a statement to the committee's Form 1120-POL in each year the designation is desired. The statement must contain the name, address, and taxpayer identification number of the candidate and of the committee. Reg. 1.527-9(b). Revocation of the designation may be made only with the consent of the Commissioner in accordance with the procedures outlined in Reg. 1.527-9(c).

**3. What is the tax treatment of a principal campaign committee?**

The political organization taxable income of a principal campaign committee is taxed at the graduated rates under IRC 11(b) rather than the highest rate specified in IRC 11(b). IRC 527(h)(1).

**4. May a principal campaign committee make contributions to campaign committees of other candidates?**

As noted above, a campaign committee will not qualify as a principal campaign committee if it supports more than one candidate for Congress. Reg. 1.527-9(a). This requirement in the regulations refers to and adopts the requirements of the regulations under the FECA. Those regulations provide that support does not include contributions by an authorized campaign committee to an authorized campaign committee of another candidate that aggregate $1,000 or less per election. 11 C.F.R. § 102.12(c). Therefore, a political organization will not qualify as a principal campaign committee if it contributes more than $1,000 per election to another candidate for Congress. However, if the committee's contributions to another Congressional candidate aggregate $1,000 or less per election, then it will continue to qualify as a principal campaign committee under IRC 527(h).

For purposes of construing the phrase "amounts aggregating $1,000 or less per election," primary and general elections are considered separate elections. Therefore, where a principal campaign committee contributed $2,000 to the authorized committee of a candidate for Congress, but designated $1,000 for the candidate's primary election and $1,000 for the general election, the contribution did not disqualify the committee from treatment as a principal campaign committee under IRC 527(h) because the $1,000 limit per election was not exceeded. See, e.g., TAM 92-24-002 (Feb. 19, 1992) and TAM 93-20-002 (Jan. 14, 1993).

Because the requirements of IRC 527(h) are imposed by reference to FEC rules and because those rules only concern federal elections, there is no limitation imposed upon the amount of contributions a principal campaign committee may make to candidates for nonfederal offices or the number of nonfederal candidates it may support. This point is also covered in TAM 92-24-002, which concludes that a principal campaign committee's contributions of $3,000 to the campaign committee of a local judge and $2,000 to the committee of a mayoral candidate had no effect upon its status as a principal campaign committee under IRC 527(h).

**5. What if a political organization no longer qualifies as a principal campaign committee because it supports more than one candidate?**

An organization that does not qualify as a principal campaign committee under IRC 527(h) solely because it supports more than one candidate for Congress, but otherwise meets the requirements for a political organization, will continue to qualify as a political organization. Contributions to another political organization are exempt function expenditures. Therefore, the political organization taxable income would be taxed at the highest rate specified in IRC 11(b) rather than at the graduated rates. IRC 527(b).

**6. Does a political organization continue to qualify as a principal campaign committee when its candidate is not seeking reelection to a Congressional office?**

A principal campaign committee is not required to terminate immediately following an election. It may remain in existence for a reasonable period of time in order to wind up the affairs of the campaign without losing its status as a political organization. Similarly, a candidate may have the political campaign committee continue in existence between election cycles for use in a reelection effort. During those periods, the political organization will continue to qualify as a principal campaign committee under IRC 527(h). However, once a candidate indicates an intention not to seek reelection, the political campaign committee may retain its status as a principal campaign committee only for the period of time reasonably necessary to wind up the affairs of the campaign. If the committee remains in existence longer than is reasonably necessary, or is converted to another use, then its status as a principal campaign committee will be terminated, even if it still qualifies as a political organization. The determination of whether the committee has remained in existence longer than reasonably necessary or has been converted to another use is based on the facts and circumstances of the situation. Some factors to be considered are whether the candidate has taken any steps towards seeking election for a different office, whether the political expenditures of the committee are primarily in support of the candidate's campaign activities (either past or future), and whether the committee makes substantial non-political expenditures.

## H. Special Rules for Newsletter Funds

**1. What must a newsletter fund do to be a political organization under IRC 527?**

To be subject to income tax only as a political organization under IRC 527, a newsletter fund must be described in IRC 527(g). (To the extent newsletter fund expenses are deductible by a public office holder under IRC 162(a), the fund may also satisfy the requirements to be a political organization as described in IRC 527(e)(1). In that case, the rules regarding political organizations generally apply in determining the organization's tax treatment, and not the rules regarding newspaper funds.)

To be described in IRC 527(g), a fund must meet three requirements. First, it must be established and maintained by an individual who holds, has been elected to, or is a candidate for nomination or election to, any federal, state, or local elective public office. Second, the fund must be established for use by such individual exclusively to prepare and circulate the individual's newsletter (the "organizational test"). Third, the fund must be maintained for use by such individual exclusively to prepare and circulate the individual's newsletter (the "operational test"). IRC 527(g)(1); Reg. 1.527-7(a).

Newsletter funds are subject to the same rules regarding taxable income as other IRC 527 organizations, except that they are not allowed to take the specific $100 deduction. Therefore, if a newsletter fund has any political organization taxable income, it must file Form 1120-POL.

**2. Must a newsletter fund maintain a "segregated fund?"**

All amounts received by a newsletter fund (and income thereon) must be segregated for use for the newsletter fund's exempt function. If amounts are not properly segregated, the fund is not described in IRC 527(g). Unlike political organizations generally, which must be organized and operated primarily for their exempt purpose, newsletter funds must be used exclusively for the preparation and circulation of the newsletter. Compare IRC 527(e)(1) to IRC 527(g)(1).

**3. What is the exempt function of a newsletter fund?**

The exempt function of a newsletter fund consists solely of preparing and circulating the newsletter. IRC 527(g)(2)(A); Reg. 1.527-7(c). Consequently, its expenditures must be characterizable as preparation and circulation expenditures, for example, expenditures for secretarial services, printing, addressing, and mailing. Campaign activities that are not attributable to the preparation and circulation of the candidate's newsletter are not exempt function activities of a newsletter fund. IRC 527(g)(2); Reg. 1.527-7(c).

**4. May newsletter fund assets be used for campaign activities?**

No, the assets of a newsletter fund may not be used for campaign activities. Reg. 1.527-7(d) provides that the exempt function of a newsletter fund does not include the following items:

(A) Expenditures for an exempt function as defined in Reg. 1.527-2(c); or

(B) Transfers of unexpended amounts to a political organization described in IRC 527(e)(1).

**5. What are the rules relating to excess funds held by a newsletter fund?**

Reg. 1.527-7(e) provides that excess newsletter funds (funds held by a newsletter fund that has ceased to engage in the preparation and circulation of the newsletter) are treated as expended for the personal use of the person who has established and maintained the fund, except to the extent that within a reasonable period of time the organization does one of the following with the excess funds:

(A) They are contributed to another IRC 527(g) newsletter fund;

(B) They are contributed to or for the use of an IRC 509(a)(1) or (2) public charity; or

(C) They are deposited in the general fund of the U.S. Treasury or in the general fund of a State or local government.

**6. What is the tax effect of making expenditures for non-exempt function activities?**

If a newsletter fund makes any expenditures for non-exempt function activities (including political activities that are exempt function activities for other political organizations), it is no longer exclusively operated for the purposes set forth in IRC 527(g) and, consequently, it loses its exempt status as an organization described in that subparagraph. See also Reg. 1.527-7(a) and (c).

Generally, loss of exempt status will operate prospectively, and the newsletter fund will be taxed pursuant to IRC 527 for prior periods. However, where a newsletter fund makes expenditures for non-exempt function activities, the facts and circumstances may indicate the fund was never established and maintained exclusively for an exempt function. In that case, loss of exempt status will operate retroactively, and the newsletter fund will not be taxed pursuant to IRC 527 for prior periods. Reg. 1.527-7(a).

**7. What is the tax effect of a newsletter fund losing its exempt status?**

If a newsletter fund loses its exempt status as an organization described in IRC 527(g), the individual who established and maintains the fund will be held to be in receipt of income in the amount of any expenditures made by the fund for non-exempt function activities during the period prior to loss of exempt status. In addition, future contributions to the fund will constitute income to such individual. If loss of exempt status operates retroactively, past contributions may also constitute income to such individual, for the periods in which received by the fund. Reg. 1.527-7(a). See Rev. Rul. 73-356, 1973-2 C.B. 31 (concerning tax treatment of non-exempt newsletter funds).

## I. Political Organizations and IRC 6113

**1. What are the general requirements of IRC 6113 for political organizations?**

IRC 6113 requires IRC 527 political organizations (as well as IRC 501(c) organizations that are ineligible to receive tax deductible charitable contributions) to disclose in "an express statement (in a conspicuous and easily recognizable format)," the nondeductibility of contributions during fundraising solicitations. A fundraising solicitation is any solicitation of contributions or gifts that is made in written form, by television or radio, or by telephone, but does not include any letter or telephone call that is not part of a coordinated fundraising campaign soliciting more than 10 persons during the calendar year. This requirement does not apply to political organizations that normally do not have gross receipts in excess of $100,000 during a tax year, although two or more organizations may be treated as one organization where necessary to prevent the avoidance of this provision through the use of multiple organizations.

Notice 88-120, 1988-2 C.B. 454, provides detailed guidance, including safe harbors, on the application of IRC 6113. The following questions and answers are based upon Notice 88-120.

**2. What are examples of solicitations that must contain the disclosure statement?**

A political organization's solicitations for all voluntary contributions as well as solicitations for attendance at testimonials and other fundraising events must include the disclosure statement. For example, solicitations by a political organization for contributions to a Congressional campaign committee must include the disclosure statement. Solicitations for memberships and annual dues, as well as solicitations for membership and dues renewals, are also subject to the requirements of IRC 6113.

**3. What are examples of situations that do not require the disclosure statement?**

Situations where a political organization is not required to make the IRC 6113 disclosure statement include billing advertisers in its publications and billing attendees at a conference it conducts (as distinguished from a testimonial or fundraising event). General material discussing a political candidacy and requesting persons to vote for the candidate or "support" the candidate need not include the disclosure statement unless the material specifically requests either a financial contribution or a contribution of volunteer services on behalf of the candidate.

**4. When does an organization have annual gross receipts that do not normally exceed $100,000?**

In determining whether an organization has annual gross receipts that do not normally exceed $100,000, the Service will generally follow the principles set forth in Reg. 1.6033-2(g) and Rev. Proc. 83-23, 1983-1 C.B. 687, which provide rules for determining annual gross receipts with respect to the similar exception from the filing of annual information returns for small organizations. In general, these rules set out a three year average as the basic rule. The organization must include the required disclosure statement on all solicitations made more than 30 days after reaching $300,000 in gross receipts for the three year period of the calculation. For example, if on July 1 of the third year of a calculation (for an organization with a calendar year accounting period) the organization reaches $300,000 in total gross receipts for the prior two years and the first six months of the third year, it must include the required disclosure statement on all solicitations no later than August 1. A local, regional, or state chapter of an organization with gross receipts under $100,000 must include the disclosure statement in its solicitations if at least 25 percent of the money solicited will go to the national, or other, unit of the organization that has annual gross receipts that exceed $100,000 because the solicitation is considered as being in part on behalf of such unit of the organization.[31]

**5. What is a qualifying print medium format?**

In the case of a solicitation by mail, leaflet, or advertisement, Notice 88-120 provides that the organization will have satisfied IRC 6113 if the following four requirements are met:

(A) The solicitation includes whichever of the following statements the organization deems appropriate: "Contributions or gifts to [name of organization] are not deductible as charitable contributions for Federal income tax purposes," "Contributions or gifts to [name of organization] are not tax deductible," or "Contributions or gifts to [name of organization] are not tax deductible as charitable contributions;"

(B) The statement is in at least the same size type as the primary message stated in the body of the letter, leaflet, or ad;

(C) The statement is included on the message side of any card or tear-off section that the contributor returns with the contribution; and

(D) The statement is in the first sentence in a paragraph or itself constitutes a paragraph.

[31] Also, if a trade association or labor union with over $100,000 in annual gross receipts solicits funds that will pass through a PAC with less than $100,000 in gross receipts, the solicitation must contain the required disclosure statement.

**6. What is a qualifying telephone solicitation format?**

In the case of a solicitation by telephone, Notice 88-120 provides that the organization will have satisfied IRC 6113 if the following three requirements are met:

(A) The solicitation includes whichever of the following statements the organization deems appropriate: "Contributions or gifts to [name of organization] are not deductible as charitable contributions for Federal income tax purposes," "Contributions or gifts to [name of organization] are not tax deductible," or "Contributions or gifts to [name of organization] are not tax deductible as charitable contributions;"

(B) The statement is made in close proximity to the request for contributions, during the telephone call, by the telephone solicitor; and

(C) Any written confirmation or billing sent to a person pledging to contribute during the telephone solicitation complies with the requirements for print medium solicitations set forth above.

**7. What is a qualifying television solicitation format?**

In the case of a solicitation by television, Notice 88-120 provides that the organization will have satisfied IRC 6113 if the following two requirements are met:

(A) The solicitation includes whichever of the following statements the organization deems appropriate: "Contributions or gifts to [name of organization] are not deductible as charitable contributions for Federal income tax purposes," "Contributions or gifts to [name of organization] are not tax deductible," or "Contributions or gifts to [name of organization] are not tax deductible as charitable contributions;" and

(B) If the statement is spoken, it is in close proximity to the request for contributions; if the statement appears on the television screen, it is in large, easily readable type appearing on the screen for at least five seconds.

**8. What is a qualifying radio solicitation format?**

In the case of a solicitation by radio, Notice 88-120 provides that the organization will have satisfied IRC 6113 if the following two requirements are met:

(A) The solicitation includes whichever of the following statements the organization deems appropriate: "Contributions or gifts to [name of organization] are not deductible as charitable contributions for Federal income tax purposes," "Contributions or gifts to [name of organization] are not tax deductible," or "Contributions or gifts to [name of organization] are not tax deductible as charitable contributions;" and

(B) The statement is made in close proximity to the request for contributions during the same radio solicitation announcement.

**9. What if a political organization makes a fundraising solicitation and does not follow the formats set forth above?**

If a political organization makes a solicitation to which IRC 6113 applies, and the solicitation does not comply with the formats set forth above, the Service will evaluate all the facts and circumstances to determine whether the solicitation contained "an express statement (in a conspicuous and easily recognizable format) that contributions and gifts are not deductible for Federal income tax purposes." IRC 6113(a). A good faith effort to comply with the requirements of IRC 6113 will be an important factor in the evaluation of the facts and circumstances. However, disclosure statements made in the fine print will not be considered to be in compliance with the statutory requirement.

**10. What are the penalties for failure to comply with the requirements of IRC 6113?**

The failure to include the required disclosure of the non-deductibility of contributions in fundraising solicitations to which IRC 6113 applies results in a penalty of $1,000 for each day on which such a failure occurs, up to a maximum penalty of $10,000. IRC 6710(a). No penalty will be imposed if the failure is due to reasonable cause. IRC 6710(b). In cases where the failure to make the required disclosure is due to intentional disregard of the law, the $10,000 per year limitation on the penalty does not apply and more severe penalties based on up to 50 percent of the aggregate cost of the solicitations are applicable. IRC 6710(c). For purposes of determining the penalty, "each day on which a failure occurs" means the day that a solicitation is mailed, distributed, published, telecast, broadcast, or spoken by telephone. IRC 6710(d). For example, if an organization mails 500 noncomplying solicitations on March 30 and 50 noncomplying solicitations on April 5, the penalty would be $2,000, so long as the violation did not involve intentional disregard of the disclosure requirement.

4. Political Activities of IRC 501(c) Organizations

A. IRC 501(c) Organizations and Political Activities

**1. May IRC 501(c) organizations engage primarily in political campaign activities?**

IRC 501(c) describes a large number of different types of organizations that are exempt from federal income taxation, including charitable organizations, labor unions, business leagues, social clubs, pension trusts, veterans associations, insurance companies, fraternal associations, and titleholding companies. None of these provisions provide specifically for participation in political campaign activity as an exempt purpose. Thus, the question becomes whether participation in a political campaign furthers the specified exempt purpose of the IRC 501(c) organization. In those cases where this question has been specifically addressed, the answer has been no.

In some instances, there are specific statutory or regulatory statements that participation in a political campaign is not in furtherance of exempt purposes. Charitable organizations described in IRC 501(c)(3) are prohibited from participating or intervening in political campaigns (see discussion in Part 2). The regulations under IRC 501(c)(4) provide that promotion of social welfare does not include participation or intervention in political campaigns. Reg. 1.501(c)(4)-1(a)(2)(ii).

G.C.M. 34233 (Dec. 3, 1969) raises this question with respect to labor unions described in IRC 501(c)(5) and business leagues described in IRC 501(c)(6). The G.C.M. contrasts support of a candidate for office with lobbying activities.[32] It notes that the content of specific legislative proposals may be readily identified and related to the business or labor interests of the organizations. Therefore, business leagues and labor unions may engage in lobbying activities that are germane to their exempt purposes as their primary activity. However, "support of a candidate for public office necessarily involves the organization in the total political attitudes and positions of the candidate." Because of this, the G.C.M. concluded that "this involvement transcends the narrower [exempt] interest" of the organization and could not be the primary activity of an organization described in either IRC 501(c)(5) or IRC 501(c)(6).

This rationale would appear to apply to other types of exempt organizations.

**2. May IRC 501(c) organizations make expenditures for IRC 527 "exempt function" activities?**

An IRC 501(c) organization may make expenditures for exempt function activities as defined in IRC 527 to the extent consistent with its exempt status. As discussed above, an IRC 501(c)(3) organization is expressly prohibited from participating or intervening in any political

[32] For an overview of the federal tax rules concerning political and lobbying activities by exempt organizations, see 2000 Joint Committee Report. For a detailed discussion of exempt organizations and lobbying activities, see 1997 CPE Text.

campaign on behalf of or in opposition to any candidate for elective public office. Some other IRC 501(c) organizations are precluded from political activities because the subparagraph in which they are described limits them to an exclusive purpose (for example, IRC 501(c)(2) title holding companies, IRC 501(c)(20) group legal services plans). Other IRC 501(c) organizations are not similarly prohibited from engaging in political activities. An IRC 501(c) organization may generally make expenditures for political activities if such activities (and other activities not furthering its exempt purposes) do not constitute the organization's primary activity. Some of the IRC 501(c) organizations that have been held to be able to engage in political activities to varying degrees are social welfare organizations described in IRC 501(c)(4) (Rev. Rul. 81-95, 1981-1 C.B. 332 -- because organization's primary activities promote social welfare, its less than primary participation in political campaigns will not adversely affect its exempt status); labor organizations described in IRC 501(c)(5) (Marker v. Schultz, 485 F.2d 1003 (D.C. Cir. 1973) and G.C.M. 36286 (May 22, 1975)); business leagues described in IRC 501(c)(6) (G.C.M. 34233 (Dec. 3, 1969)); and fraternal beneficiary societies described in IRC 501(c)(8) (PLR 83-42-100 (July 20, 1983)).

**3. What effect does political activity by an IRC 501(c) organization have on the deductibility of dues or contributions to the organization?**

Generally, amounts paid to IRC 501(c) organizations other than IRC 501(c)(3) organizations are not deductible as charitable contributions. Nevertheless, in some instances, dues or contributions to such organizations may be deductible as business expenses under IRC 162. However, amounts paid for intervention or participation in any political campaign may not be deducted as a business expense. IRC 162(e)(2)(A). Therefore, any amounts paid to an IRC 501(c) organization that are specifically for political activities would not be deductible under IRC 162. Furthermore, if a substantial part of the activities of the IRC 501(c) organization consists of political activities, a deduction under IRC 162 is allowed only for the portion of dues or other payments to the organization that the taxpayer can clearly establish was not for political activities. Reg. 1.162-20(c)(3). However, until 1993, no mechanism existed at the association level to ensure notification to members of the disallowance.

In 1993, Congress enacted the Omnibus Budget Reconciliation Act of 1993 (OBRA 1993) which disallowed the deduction for direct lobbying at the Federal and state level as a business expense under IRC 162. Grassroots lobbying and political campaign activity continued to be nondeductible. In addition, § 13222 of OBRA 1993 amended IRC 6033, adding a new subsection to provide a system based on the disallowance of dues that builds in an incentive (or penalty) to ensure that associations notify their members. The trigger is contained in IRC 6033(e), which imposes reporting and notice requirements on tax-exempt organizations incurring expenditures to which IRC 162(e) applies. IRC 162(e)(3) denies a deduction for the dues (or other similar amounts) paid to certain tax-exempt organizations to the extent that the organization, at the time the dues are assessed or paid, notifies the dues payer that the dues are allocable to nondeductible lobbying and

political expenditures of the type described in IRC 162(e)(1).[33] The reporting and notice requirements and proxy tax under IRC 6033(e) are discussed in Section D.

B. Tax on Political Expenditures - IRC 527(f)

**1. What if an IRC 501(c) organization makes expenditures for political activities?**

Except for expenditures made from a separate segregated fund under IRC 527(f)(3), an IRC 501(c) organization that makes expenditures for exempt function activities is subject to tax under IRC 527(b). IRC 527(f)(1) provides that the tax base is an amount equal to the lesser of (1) the organization's net investment income for the taxable year in which such expenditures are made, or (2) the aggregate amount of expenditures for exempt function activities during the year. This treatment applies whether the IRC 501(c) organization makes such expenditures directly, or through another organization. Thus, an IRC 501(c) organization may not avoid taxation under IRC 527(f)(1) by establishing a separate organization to make expenditures for exempt function activities, except as provided in IRC 527(f)(3).

**2. What is included in net investment income?**

IRC 527(f)(2) defines net investment income as the excess of (a) the gross amount of income from interest, dividends, rents, and royalties, plus the excess (if any) of gains from the sale or exchange of assets over the losses from the sale or exchange of assets, over (b) allowable deductions which are directly connected with producing such income. Income and expenses taken into account for purposes of the unrelated business income tax under IRC 511 are not taken into account in calculating net investment income for purposes of IRC 527(f)(2).

**3. Is interest on state or local bonds excluded in determining net investment income?**

Interest on state or local bonds, within the meaning of IRC 103, should be excluded in determining net investment income under IRC 527(f)(2). In determining the gross amount of income from interest, etc., the definition of gross income under IRC 61 and the exclusions from gross income thus defined apply. Expenses directly connected with the production of interest on state or local bonds may not be deducted in determining net investment income.

[33] Payments that are similar to dues include voluntary payments or special assessments used to conduct political campaign activities.

**4. What is deductible in determining net investment income?**

Deductions allowed in determining net investment income under IRC 527(f)(2) must meet the same requirements as deductions allowed under IRC 527(c)(1). Expenses, depreciation, and similar items must qualify as deductions allowed under Chapter 1 and must be directly connected with the production of the gross amount of income which is subject to tax. Reg. 1.527-4(c)(1). Directly connected deductions have a proximate and primary relationship to the production of the taxable income and are incurred in the production of such income. The determination of whether a deduction was incurred in the production of taxable income is made on the basis of the relevant facts and circumstances. An item attributable solely to items of taxable income is proximately and primarily related to such income. Reg. 1.527-4(c)(2). For example, state income taxes paid on net investment income are attributed solely to items of taxable income and thus have a proximate and primary relationship with producing that income. Since IRC 164 allows a deduction for such taxes, they are deductible in computing net investment income under IRC 527(f). See Rev. Rul. 85-115, 1985-2 C.B. 172. The legislative history indicates that indirect expenses (such as general administrative expenses) are not allowed as deductions as these amounts were expected to be relatively small so that eliminating them would simplify the tax calculation. S. Rep. No. 93-1357, 93d Cong., 2d Sess. 29 (1974), 1975-1 C.B. 527, 533. The modifications under IRC 527(c)(2) also apply in computing the tax under IRC 527(f)(1). Reg. 1.527-6(d).

**5. Are all expenditures that are considered exempt function expenditures for political organizations identically treated when carried on by an IRC 501(c) organization?**

No, not all expenditures that are considered exempt function expenditures for political organizations are treated as taxable expenditures when carried on by an IRC 501(c) organization. Reg. 1.527-6(b)(4) and Reg. 1.527-6(b)(5) provide two specific exceptions. Under Reg. 1.527-6(b)(4), where an IRC 501(c) organization appears before any legislative body for the purpose of influencing the appointment or confirmation of an individual to a public office, any expenditure relating to such appearance is not treated as an exempt function expenditure.[34] The exception provided by Reg. 1.527-6(b)(5) relates to expenditures for nonpartisan activities (including nonpartisan voter registration and "get-out-the-vote" campaigns). To come within the exception, nonpartisan voter registration and "get-out-the-vote" campaigns must not be specifically identified by the organization with any candidate or political party.

[34] This exception is similar to, but more limited than, the "furnishing technical advice or assistance" exception relating to lobbying by IRC 501(c)(3) organizations under IRC 4911 and 4945. The exception contained in Reg. 1.527-6(b)(4) only concerns certain requested appearances before legislative bodies, whereas "technical advice or assistance" may be given otherwise than by appearance. Furthermore, the exception under Reg. 1.527-6(b)(4) only applies to appearances relating to appointments and confirmations, while the subject matter of the "technical advice or assistance" exception is unlimited.

**6. Are an IRC 501(c) organization's expenditures allowed by the FECA (2 U.S.C. § 441b(b)(2)(C)) and its indirect expenses relating to political campaign activity considered exempt function expenditures?**

Both issues are unresolved. With respect to the FECA issue, the statute specifically permits labor unions and trade associations to spend money for (1) internal communications with members, stockholders, and their families (but not to the general public) that might involve support of particular candidates; (2) the conduct of nonpartisan registration and get-out-the-vote campaigns aimed at their members, stockholders, and families; and (3) the establishment, administration, and solicitation of contributions to separate segregated funds to be used for political purposes. As a result, when the regulations under IRC 527 were published in proposed form, several commentators suggested that these expenditures, which are made routinely by some IRC 501(c) organizations and are regarded as appropriate under the FECA for such organizations, should be treated differently from identical expenditures made by political organizations. In other words, the commentators suggested that such expenditures continue to be treated as "exempt function" activities for political organizations (including separate segregated funds of IRC 501(c) organizations) but not for IRC 501(c) organizations.

No final determination of the issue was made; therefore, the treatment of expenditures allowed by the FECA is reserved in the final regulations. Reg. 1.527-6(b)(3).

The treatment of indirect expenses also is reserved in the final regulations. Reg. 1.527-6(b)(2). As noted above, indirect expenses are defined in Reg. 1.527-2(c)(2) as expenses, such as overhead and record keeping, that are necessary to support directly related exempt function activities.

The Supplementary Information to the final regulations, T.D. 7744, 1981-1 C.B. 360, 361, explains that when these two subparagraphs (Reg. 1.527-6(b)(2) and (3)) are adopted as a final regulation, they will apply on a prospective basis. This means that an IRC 501(c) organization currently may engage in activities permitted by the FECA or may make any indirect exempt function expenditures and will not be subject to tax with respect to such expenditures under IRC 527. This situation may change when Reg. 1.527-6(b)(2) and (3) are promulgated, but there is no indication at present as to how or when the matters will be resolved. In summary, any decision with regard to the adverse treatment of such expenditures will be applied on a prospective basis from the date of any such decision.

As a result of these reserved provisions, an IRC 501(c) organization may pay for the indirect expenses of an IRC 527 organization without incurring tax under IRC 527(f). However, to take advantage of this situation, an IRC 501(c) organization must actually pay the indirect expenses. In TAM 94-33-001 (Jan. 26, 1994), for example, an IRC 501(c)(6) organization that made payments to the general treasury of its affiliated political action committee was determined to be subject to the tax under IRC 527(f). Although the IRC 501(c)(6) organization stated that it intended the payments to be used to defray the administrative costs of the political action committee, it made the payment

directly to the general treasury of the political action committee, took no steps to ensure that the funds were used solely for the indirect expenses of the political action committee, and based the amount paid on the number of its members rather than on any determination of actual indirect expenditures made by the political action committee.

**7. Is an IRC 501(c) organization absolutely liable for amounts transferred to an individual or organization that are used for political purposes?**

No. While an expenditure may be made for an exempt function directly or through another organization, an IRC 501(c) organization will not be absolutely liable under IRC 527(f)(1) for amounts transferred to an individual or organization. An IRC 501(c) organization is, however, required to take reasonable steps to ensure that the transferee does not use such amounts for an exempt function. Reg. 1.527-6(b)(1)(ii).

C. Separate Segregated Fund Under IRC 527(f)

**1. What is the tax treatment to an IRC 501(c) organization of expenditures for political activities made by a separate segregated fund maintained by the organization?**

Expenditures for exempt function activities made by a separate segregated fund described in IRC 527(f)(3) are considered as made by an organization separate from the IRC 501(c) organization that maintains the fund. IRC 527(f)(3). Thus, an IRC 501(c) organization is not subject to tax under IRC 527 by reason of expenditures for exempt function activities made by a separate segregated fund that it maintains.

**2. What is a separate segregated fund?**

A separate segregated fund is a fund maintained by an IRC 501(c) organization that is a "separate segregated fund" within the meaning of 2 U.S.C. § 441b(b) (formerly 18 U.S.C. § 610), or of a similar state statute, or within the meaning of a state statute that permits the segregation of dues money for expenditure for political campaign activities. IRC 527(f)(3).

**3. How is a separate segregated fund taxed?**

If a separate segregated fund meets the requirements for a political organization under IRC 527(e)(1), it is treated for tax purposes as a political organization. Reg. 1.527-6(f). Expenditures by the separate segregated fund for non-exempt function activities would have the same result as expenditures made by any other political organization. See Part 3 for a discussion of the taxation of political organizations.

If a separate segregated fund does not meet the requirements for a political organization under IRC 527(e)(1), it is subject to tax, as a taxable organization, under general tax principles. See IRC 527(f)(3), which provides that a separate segregated fund "shall be treated as a separate organization."

**4. What is the tax treatment of a fund that loses its status as a separate segregated fund under applicable federal or state law?**

If a fund loses its status as a separate segregated fund under applicable federal or state law, it is no longer treated as a separate organization for federal tax purposes. IRC 527(f)(3). In that event, expenditures made from such a fund will subject the IRC 501(c) organization that maintains it to tax, pursuant to IRC 527(f)(1). For example, see TAM 96-16-002 (Dec. 13, 1995), where an account established as a separate segregated fund of an IRC 501(c)(5) organization lost that status by failing to meet the operational test. The account was not treated as a separate entity, but as a bank account of the IRC 501(c)(5) organization.

**5. Is a transfer of dues or political contributions by an IRC 501(c) organization to a separate segregated fund an exempt function expenditure?**

A transfer of dues or political contributions by an IRC 501(c) organization to a separate segregated fund is an exempt function expenditure of the IRC 501(c) organization unless the transfer is made promptly after the receipt of such amounts by the IRC 501(c) organization and is made directly to the separate segregated fund. Reg. 1.527-6(e). Reg. 1.527-6(e) also provides that a transfer is considered promptly and directly made if the following conditions are met:

(A) The procedures followed satisfy applicable federal or state campaign law and regulations;

(B) The IRC 501(c) organization maintains adequate records to show that amounts transferred were political contributions and dues and not investment income; and

(C) The political contributions and dues were not used to earn investment income for the IRC 501(c) organization.

For example, an IRC 501(c) organization that collected political contributions and dues along with other receipts from its members and deposited all amounts collected in an interest-bearing checking account did not make an exempt function expenditure when it subsequently transferred the political contributions and dues to the separate segregated fund. The IRC 501(c) organization maintained records showing the amount of political contributions and dues received and, once or twice a month, transferred the amounts collected in the immediately preceding month or half-month period to the separate segregated fund. Although the small amount of interest earned on these funds

was retained by the IRC 501(c) organization, the funds were deposited in the interest-bearing account primarily as an administrative convenience and not to earn investment income. See G.C.M. 39837 (May 22, 1990).

In Alaska Public Service Employees Local 71 v. Commissioner, T.C.M. 1991-650, an IRC 501(c)(5) organization maintained a separate segregated fund. The primary source of funds for the separate segregated fund consisted of contributions from members of the IRC 501(c)(5) organization. Five percent of the general fund dues were allocated to the political fund unless discontinued by the member and some additional contributions were withheld from the salary of the office staff of the IRC 501(c)(5) organization. These amounts were deposited in the general fund and promptly transferred (up to four times a month) to the separate segregated fund. It was agreed that these amounts did not constitute an exempt function expenditure by the IRC 501(c)(5) organization. However, in addition to these amounts, the organization authorized a transfer of $25,000 to the separate segregated fund from its general fund. During that year, the IRC 501(c)(5) organization had more than $25,000 of net investment income. Three years later, after the Service proposed to assess tax under IRC 527 on the amount transferred, the IRC 501(c)(5) organization attempted to reverse the transaction by transferring $25,000 from the separate segregated fund to the general fund. The court held that since the IRC 501(c)(5) organization failed to show that the transfer consisted of dues and not investment income and that the dues had not been used to earn investment income prior to the transfer, the $25,000 transfer was an exempt function expenditure subject to tax under IRC 527(f)(1). The court further held that the IRC 501(c)(5) organization's attempt to reverse the transaction was not effective.

**6. May an IRC 501(c) organization whose income is derived from fees and donations establish a separate segregated fund?**

An IRC 501(c) organization that derives its income from fees and donations is not prohibited from establishing a separate segregated fund. Amounts contributed by others directly to the separate segregated fund and expenditures made by the fund will not be attributed to the IRC 501(c) organization for the purposes of the tax under IRC 527.

The question of whether transfers from the IRC 501(c) organization to the separate segregated fund will be considered exempt function expenditures of the IRC 501(c) organization is determined on the basis of the relevant facts and circumstances. Amounts transferred from the general fund of the IRC 501(c) organization will be considered exempt function expenditures causing the organization to be subject to tax under IRC 527. Amounts collected by the IRC 501(c) organization that are designated for the separate segregated fund and are promptly and directly transferred to the separate segregated fund in accordance with Reg. 1.527-6(e) will not be considered exempt function expenditures of the IRC 501(c) organization.

**7. May an IRC 501(c)(4) organization that has a related IRC 501(c)(3) organization also have a related PAC?**

There is nothing that prohibits an IRC 501(c)(4) organization that has a related IRC 501(c)(3) organization from also having a related PAC. However, the same concerns apply when an IRC 501(c)(4) organization with a related IRC 501(c)(3) organization conducts political activities through a PAC as when it conducts those activities itself. Like the situation with IRC 501(c)(4) organizations, contributions to a PAC are not tax-deductible. Therefore, to ensure that no tax-deductible contributions are used to support the political campaign activity of the PAC, it must be separately organized and adequate records must be maintained.

As with political activities conducted directly by IRC 501(c)(4) organizations, a particular concern is the allocation of income and expenses when an IRC 501(c)(3) organization and a related PAC share staff, facilities, or other expenses or conduct joint activities. The determination of whether the allocation method used is appropriate and reasonable is based upon the relevant facts and circumstances.[35]

D. IRC 6033(e) Reporting and Notice Requirements and Proxy Tax

(1) Organizations Excepted from the Reporting and Notice Requirements

**1. Are all IRC 501(c) organizations subject to the requirements of IRC 6033(e)?**

No, IRC 6033(e)(1)(B)(i) provides that the IRC 6033(e) notice requirements do not apply to IRC 501(c)(3) organizations. In addition, IRC 6033(e)(3) provides an exception for organizations that establish to the satisfaction of the Secretary that substantially all of the dues or similar amounts received by the organization are not deducted by its members as business expenses. Most IRC 501(c) organizations do not receive dues that are deducted by their members as business expenses under IRC 162. Therefore, the Service provides in Rev. Proc. 98-19, 1998-1 C.B. 547, § 4.01, that, pursuant to IRC 6033(e)(3), the requirements of IRC 6033(e) shall not apply to organizations recognized by the Service as exempt from taxation under IRC 501(a), other than (1) IRC 501(c)(4) social welfare organizations that are not veterans organizations, (2) agricultural and horticultural organizations described in IRC 501(c)(5), and (3) IRC 501(c)(6) organizations.

**2. Which IRC 501(c)(4) and IRC 501(c)(5) organizations does Rev. Proc. 98-19 except?**

IRC 501(c)(4) veterans' organizations and IRC 501(c)(5) labor organizations are excepted by the Service from the IRC 6033(e) requirements in Rev. Proc. 98-19, § 4.01. Other IRC 501(c)(4) social welfare organizations and IRC 501(c)(5)

[35] See Part 2, Section F, for a discussion of affiliation with IRC 501(c)(3) organizations. See, also, Appendix IV for brief descriptions of some of the types of affiliations possible with exempt organizations.

agricultural and horticultural organizations that meet a safe harbor set forth in Rev. Proc. 98-19, § 4.02, also will be excepted from IRC 6033(e). The safe harbor provides that these organizations are not subject to IRC 6033(e) if more than 90 percent of their annual dues (or similar amounts) are received from members paying annual dues (or similar amounts) of $75 or less,[36] or from (1) IRC 501(c)(3) organizations, (2) state or local governments, (3) entities whose income is exempt from tax under IRC 115, or (4) organizations excepted by § 4.01 of Rev. Proc. 98-19 as noted above. Organizations that do not meet the safe harbor may establish that they satisfy the requirements of IRC 6033(e)(3) by maintaining records establishing that at least 90 percent of the annual dues received by the organization are not deductible by its members (without regard to IRC 162(e)) and notifying the Service on its Form 990, *Return of Organization Exempt from Income Tax*, that it is described in IRC 6033(e)(3).[37] Rev. Proc. 98-19, § 5.06.

**3. What organizations described in IRC 501(c)(6) are excepted by Rev. Proc. 98-19?**

Generally, IRC 501(c)(6) organizations are subject to the IRC 6033(e) requirements. However, Rev. Proc. 98-19, § 4.03, provides an exception for IRC 501(c)(6) organizations if over 90 percent of their annual dues (or similar amounts) are received from (1) IRC 501(c)(3) organizations, (2) state or local governments, (3) entities whose income is exempt from tax under IRC 115, or (4) organizations excepted by § 4.01 of Rev. Proc. 98-19, as noted above. IRC 501(c)(6) organizations that do not meet this test may also establish that they satisfy the requirements of IRC 6033(e)(3) by maintaining records establishing that at least 90 percent of the annual dues received by the organization are not deductible by its members (without regard to IRC 162(e)) in the same manner as IRC 501(c)(4) and IRC 501(c)(5) organizations and notifying the Service on its Form 990 that it is described in IRC 6033(e)(3).[38] Rev. Proc. 98-19, § 5.06.

**4. What are "annual dues" and "similar amounts?"**

The term "annual dues" means the amount an organization requires a person to pay to be recognized by the organization as a member for an annual period. "Similar amounts" includes, but is not limited to, voluntary payments made by persons, assessments made by the organization to cover basic operating costs, and special assessments imposed by the organization to conduct lobbying activities. Rev. Proc. 98-19, § 5.01. "Member" is used in its broadest sense and is not

[36] The $75 amount will be increased for years after 1998 by a cost-of-living adjustment under IRC 1(f)(3), rounded to the next highest dollar. Rev. Proc. 98-19, § 5.05. For tax years beginning in 2001, this amount is $81. Rev. Proc. 2001-13, 2001-03 I.R.B. 337, § 3.21.

[37] The organization may also request a private letter ruling to this effect in accordance with the procedures set forth in Rev. Proc. 2001-4, 2001-1 I.R.B. 121. If an organization receives a favorable private letter ruling, the Service will not contest its entitlement to exemption under IRC 6033(e)(3) for a subsequent year so long as the character of its membership is substantially similar to its membership at the time of the ruling.

[38] IRC 501(c)(6) organizations may also request a private letter ruling as discussed above.

limited to persons with voting rights in the organization. Rev. Proc. 98-19, § 5.02. If payment for a "membership" is intended to provide more than one person with recognition by the organization as a member for an annual period, annual dues is the full amount of payment request for that category of membership.

**5. How does Rev. Proc. 98-19 treat affiliated organizations?**

Rev. Proc. 98-19 provides a special aggregation rule that treats affiliated organizations (a national trade association that has state and local chapters) as a single organization for purposes of IRC 6033(e). The rule provides that if more than one organization described in IRC 501(c)(4), IRC 501(c)(5), or IRC 501(c)(6) share a name, charter, historic affiliation, or similar characteristics, and coordinate their activities, organizations in the affiliate structure are treated as a single organization. In applying the tests set forth in the safe harbor, only dues paid by the "ultimate members," whether paid to one level, which then remits the amounts to other levels in the structure, or paid separately to each level, are considered. Amounts paid by one organizational level to another are not considered, even if they are characterized as "dues." If the organization as a whole meets the requirements of IRC 6033(e)(3), (more than 90 percent of the dues are received from persons paying $75 or less) all organizations in the affiliated structure meet the requirements.[39] Rev. Proc. 98-19, § 5.03.

Rev. Proc. 98-19, § 5.04, provides an example applying the affiliation rule. A group of national, state, and local IRC 501(c)(4) organizations share a common name and work jointly to promote their purpose. Individuals or families pay annual dues of $75 to the local organizations, entitling them to membership in the national and state organizations. The local organizations remit a portion of the dues to the state and national organizations. These remittances by the local organizations exceed $75. The total amount received by all local organizations is $950x. In addition, corporations pay dues of $500 to and become members of the national organization. The total amount received from these members is $50x. Since the $950x exceeds 90 percent of the $1000x received from all members, all of the national, state, and local organizations meet the requirements of IRC 6033(e)(3). The transfers from the local organization are not considered in this determination.

(2) Exempt Organization Requirements

**1. How are exempt organizations taxed under IRC 6033(e)?**

As discussed above, organizations may not avoid the disallowance of the deduction for political campaign activity by deducting dues paid to tax-exempt organizations that engage in political campaign activity. Thus, to prevent this avoidance, IRC 6033(e) provides that organizations subject to its provisions are required to provide a notice to its members indicating the nondeductible portion

[39] If organizations within the affiliated structure are on different taxable years, the organizations may base their calculations of annual dues received on any single reasonable taxable year.

of dues paid due to political campaign activities. If the exempt organization does not provide the notice or if its actual political campaign expenditures exceed the amount disclosed in the notice, the organization will be subject to a proxy tax on the amount that should have been included in the notice but was not. The proxy tax is equal to this amount multiplied by the highest corporate rate imposed by IRC 11. IRC 6033(e)(2). Thus, the organization has the option of providing a notice to its members of the amount of dues that is not deductible due to political campaign activities or paying the proxy tax.

**2. What notices must be provided to members?**

An organization subject to IRC 6033(e) is required to provide notice to each person paying dues of the portion of dues that the organization reasonably estimates will be allocable to the organization's political campaign expenditures during the year and, thus, is not deductible by the member. This estimate must be provided at the time of assessment or payment of the dues and must be reasonably calculated to provide the organization's members with adequate notice of the nondeductible amount. IRC 6033(e)(1)(A)(ii). The legislative history indicates that the notice should be provided in a conspicuous and easily recognizable format, referring to IRC 6113 and the regulations thereunder for guidance regarding the appropriate format of the disclosure statement.[40]

**3. What information must be disclosed on the Form 990?**

IRC 501(c)(4), IRC 501(c)(5), and IRC 501(c)(6) organizations are required to disclose information regarding their political campaign activities on Form 990, *Return of Organization Exempt from Income Tax*. If an organization is excepted from the IRC 6033(e) requirements either because substantially all of its dues were not deductible by its members or because its direct lobbying expenditures consisted solely of in-house expenditures that did not exceed $2,000, it must disclose this information on the Form 990. If the organization does not meet either of these exceptions, it must disclose the information necessary to determine if it is subject to the proxy tax. This information consists of the total dues received from members, the amount of its IRC 162(e) lobbying and political campaign expenditures, and the amount it disclosed to its members as the nondeductible portion of dues. IRC 6033(e)(1)(A)(i).

**4. What amount is disclosed on the Form 990 as IRC 162(e) lobbying and political campaign expenditures?**

The amount disclosed begins with the organization's lobbying and political campaign expenses determined in accordance with IRC 162(e). Thus, direct lobbying of local councils or similar governing bodies with respect to legislation of direct interest to the organization or its members and in-house direct lobbying expenses if the total of such expenditures is $2,000 or less

[40] For guidance regarding IRC 6113, see Notice 88-120, 1988-2 C.B. 454, discussed above in Part 3, Section I. However, unlike IRC 6113, there is no penalty associated with failure to provide the disclosure notice in this format.

(excluding allocable overhead expenses) should be excluded from the amount disclosed. IRC 162(e)(2) and IRC 162(e)(5)(B). Amounts carried over from prior years, either because the lobbying and political campaign expenditures exceeded the dues received in those years or because the organization received a waiver of the proxy tax imposed on that amount must be included. IRC 6033(e)(1)(C) and IRC 6033(e)(2)(B). The current year's lobbying and political campaign expenditures should be reduced, but not below zero, by costs allocated in a prior year to lobbying and political campaign activities that were cancelled after a return reporting these costs was filed in accordance with Reg. 1.162-29(e)(2).

**5. What amount is disclosed for nondeductible dues notices?**

If the organization notified its members in accordance with IRC 6033(e)(1)(A)(ii) of its estimate of the portion of dues that would not be deductible under IRC 162(e), it must disclose on Form 990 the total amount of dues that its members were notified were nondeductible. For example, if the organization timely notified its members that 25 percent of their dues would be nondeductible and the members paid a total of $100,000 of dues allocable to the year, the amount reported on Form 990 would be $25,000.

**6. What if lobbying and political campaign expenditures exceed the estimated amount?**

If the actual lobbying and political campaign expenditures of an organization subject to IRC 6033(e) exceed the amount that it notified its members was not deductible (either because the expenses were higher than anticipated or the dues receipts were lower), the organization is liable for a proxy tax on the excess amount. IRC 6033(e)(2)(A). The organization may seek a waiver of the proxy tax.[41]

**7. How does an organization request a waiver?**

A waiver of the proxy tax is requested on Form 990. The organization checks a box agreeing to add the amount it entered as its taxable amount of lobbying and political campaign expenditures to its dues estimate for the following year and enter the amount on the next year's Form 990. An organization may use this waiver procedure only if it sent dues notices at the time of assessment or payment of dues that reasonably estimated the dues allocable to nondeductible lobbying and political campaign expenditures.

[41] It is also possible that an organization could overstate the portion of the dues that are not deductible in the notice of disallowance. It could do so by overestimating the amount of the disallowed expenses or underestimating dues income. The Conference Report indicates that guidance should be issued to cover this eventuality. H.R. Rep. No. 103-213, 103d Cong., 1st Sess. 608 n. 66 (1993), reprinted in 1993-3 C.B. 393, 486. Therefore, the legislative history clearly indicates that organizations that overstate the portion of dues that are not deductible may be able to take this excess into account. Until such time as guidance is issued, a reasonable method would be to treat an overstatement similarly to an understatement and take the excess amount into account in the following year by subtracting it from the estimate of lobbying and political campaign expenses for that year.

**8. How is the IRC 6033(e) proxy tax determined?**

As noted above, an organization subject to IRC 6033(e) must report on the Form 990 the total dues it received from members, the amount of its IRC 162(e) lobbying and political campaign expenditures for the year, and the amount it disclosed to its members as the nondeductible portion of dues. The amount subject to the IRC 6033(e)(2) proxy tax is its lobbying and political campaign expenditures under IRC 162 less the amount disclosed to the members as nondeductible. However, if this amount is more than the amount by which the total dues received exceeds the amount disclosed to the members as nondeductible, then the tax is imposed on the lesser amount and the excess is carried over to the next year. For example, an organization reports on the Form 990 that its lobbying and political campaign expenditures under IRC 162(e) for the taxable year were $600x and the aggregate amount of nondeductible dues notices is $100x. If the total amount of dues received was $800x, then the taxable amount would be $500x ($600x - $100x). However, if the total amount of dues received was $400x, the taxable amount would be limited to $300x ($400x - $100x) and the excess $200x ($500x - $300x) would be carried over and included in the next year's IRC 162 lobbying and political campaign expenditures.

The taxable amount is multiplied by the highest rate specified in IRC 11 to determine the IRC 6033(e) proxy tax. If the organization elects to pay the tax, it is reported on Form 990-T, *Exempt Organization Business Income Tax Return (and proxy tax under section 6033(e))*. When an organization elects to pay the proxy tax rather than to provide its members with an estimate of dues allocable to IRC 162(e) lobbying and political campaign expenditures, all of the members' dues remain eligible for deduction to the extent otherwise deductible. The organization may also request a waiver of this tax if it made a reasonable estimate and agrees to adjust its notice of IRC 162(e) lobbying and political campaign expenditures to members in the following year. Thus, in the second example above, if the organization requested a waiver, both the excess amount and the taxable amount would be carried over and included in the next year's IRC 162 lobbying and political campaign expenditures.

**9. Must estimated tax on the proxy tax be paid?**

No, organizations subject to IRC 6033(e) are not required to pay estimated tax on the IRC 6033(e) proxy tax, even if they do not provide notices to their members. The instructions for Form 990-T indicate that theproxy tax is not to be included when calculating estimated tax liability.

**10. What if political campaign expenditures are under-reported?**

Under-reported political campaign expenditures are subject to the IRC 6033(e) proxy tax for the year at issue only to the extent that the same expenditures (if actually reported) would have resulted in a proxy tax liability for that year. A waiver of the proxy tax for the taxable year only applies to reported expenditures. Under-reporting

political campaign expenditures may also subject the organization to a $10 per day penalty under IRC 6652 for filing an incomplete or inaccurate return.

## APPENDIX I

### The Enactment of the Political Campaign Prohibition for Charitable Organizations

As mentioned above, there is no legislative history concerning the enactment of the political campaign prohibition beyond the mere fact that Lyndon Johnson proposed it and it was accepted and enacted.

Why Johnson proposed the political campaign prohibition in the first place has been the subject of considerable interest. At least four scenarios have been proposed; three of which indicate that the purpose was to punish a charitable organization that was assisting his opponent, Dudley Dougherty, in the 1954 Texas Senatorial Primary.

The first scenario is that Johnson "offered the amendment out of concern that funds provided by a charitable organization were being used to help finance the campaign of [Mr. Dougherty]." Hopkins, The Law of Tax Exempt Organizations (7th ed.) 504 (1998).[42]

The other two surmises that focus on the Johnson-Dougherty primary campaign as the cause of the amendment mention a specific organization and seem to indicate in each case that it was the charity's activity, not its financial help, that triggered Johnson's reaction. One points to an organization established by the Texas billionaire, H. L. Hunt. Lobbying and Political Activities of Tax-Exempt Organizations, Hearings before the Subcommittee in Oversight, Committee on Ways and Means, House of Representatives, 100th Cong., 1st Sess. 144 (1987) (hereinafter 1987 Oversight Hearings) (statement of William Lehrfeld). This organization, Facts Forum, produced various radio and television programs, "Answers for Americans," "State of the Nation," and "Facts Forum," and claimed a listening and viewing audience of at least 5,000,000. It also published a periodical, Facts Forum News, with a claimed circulation of 60,000[43] No one has uncovered specific evidence that Facts Forum intervened in the primary campaign. However, George Reedy, then a principal aide on Johnson's Senate staff, noted in a 1987 letter to the United States Catholic Conference (hereinafter USCC) that while he had no recollection of the legislation, "it is entirely possible that he was

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[42] In his book, Mr. Hopkins does not cite a source. However, D. Benson Tesdahl, "Intervention in Political Campaigns After the Pickle Hearings - A Proposal for the 1990s," 4 Exempt Organization Tax Review 1165, 1178 n. 26 and 1179 n. 38 (Nov. 1991) discloses that Mr. Hopkins has stated that his information concerning Lyndon Johnson's motive came from a conversation he had with Lawrence M. Woodworth. According to this account, Mr. Woodworth stated that Johnson was upset about support a political opponent had received from a charity and directed Mr. Woodworth to draft the language that Johnson proposed on the Senate floor the same day. Mr. Woodworth conveyed no further information other than that Senator Johnson did not want any legislative history; however, as a staff member (he did not become Chief of Staff of the Joint Committee on Taxation until 1964), it is doubtful he had any.

[43] Facts Forum was created in June 1951. It was terminated in November 1956 because, as a spokesman for Mr. Hunt announced, "he's tired of fighting for useless and lost causes." Mr. Hunt's resolve did not last long. In the summer of 1958, he essentially recreated Facts Forum when he established LIFE LINE, which continued to exist until the early 1970s. (Facts Forum and LIFE LINE are often confused.) A general description of the history of these organizations is found in Harry Hurt III's biography of H. L. Hunt, Texas Rich (1991). The activities of Facts Forum are chronicled in a series by Ben Bagdikian that appeared in the Providence Journal-Bulletin, Jan. 1954) and was reprinted in The Reporter (Feb. 16, 1954). Unfortunately, the material does not cover the period with which we are concerned.

irritated by the activities of Dougherty's followers -- especially H. L. Hunt." (Letter reprinted in 1987 Oversight Hearings, 448.)

The most extensive research on this issue has been performed by the USCC. The material the USCC collected was explained and presented in a written submission to the 1987 Oversight Hearings, 419-452, and indicates that Johnson's provision may have been directed at the activities of yet another organization, the Committee for Constitutional Government (hereinafter "Committee").[44] The USCC's perusal of documents at the Lyndon Baines Johnson Presidential Library disclosed a June 15, 1954, memorandum from George A. Siegel, a Johnson aide who later became General Counsel for the Senate Democratic Policy Committee. Mr. Siegel's memorandum responded to a question by Johnson "as to whether any Texas election laws have been violated by the Committee in circulating the Ballinger article on Dudley Dougherty and by printing a box on its brochure urging people to write to Dougherty and let him know their views on his platform." Mr. Siegel's response stated his opinion that the Committee should be regarded having violated Texas election law "by having provided an indirect means for corporations to contribute to the political candidacy of Dougherty," but noted, in passing, that the activities presumably would not jeopardize its tax-exempt status under IRC 101(6) (the predecessor of IRC 501(c)(3)). (Letter reprinted in 1987 Oversight Hearings, 446-447.) As it did with Mr. Reedy, the USCC wrote to Mr. Siegel in an attempt to gather further information. Mr. Siegel responded by telephone, stating he was unable to recall any particulars due to the passage of time.

Another document uncovered indicated that Johnson asked John W. McCormack, then the Democratic Whip in the House of Representatives, to write the Service's Commissioner, T. Coleman Andrews, concerning the Committee's tax-exempt status. Commissioner Andrews responded on June 28, 1954. He stated that the Service "was taking appropriate steps to see just what is the effect of these activities under the internal revenue laws and what, if anything, can be done about their present status in relation to exemption privileges." Representative McCormack forwarded the Commissioner's reply to Johnson's office. It was received July 2, 1954, the date the floor amendment was presented. (Letters reprinted in 1987 Oversight Hearings, 451-452.)

The proximity in time between the investigation of the Committee's status and the floor amendment makes it very possible that the Committee was indeed the target of the amendment. It would also furnish an explanation both of the breadth of the description of political campaign activities and of the absoluteness of the prohibition. There is, however, yet another possibility that would also fit into the time frame, would also explain the extent and absoluteness of the amendment, but had nothing to do with the Johnson-Dougherty primary. Instead, this fourth scenario, set forth by Mr. Leonard Silverstein (1987 Oversight Hearings, 148-149), raises the possibility that the amendment was presented to trump an even more restrictive proposed addition to the 1954 Code. Mr. Silverstein noted that Johnson's amendment was presented to and adopted by the Senate on July 2, 1954, one day after Senator Patrick Anthony (Pat) McCarran had introduced a similar but much

[44] A summary of the USCC's findings are set forth in Deirdre Dessingue Halloran and Kevin M. Kearney, "Federal Tax Code Restrictions On Political Activity," 38 Catholic Law. 105, 106-108 (1998). Ms. Halloran, Associate General Counsel of the USCC, was involved in the USCC's search for documentary evidence regarding the origin of the political campaign prohibition.

harsher amendment that would have revoked the exempt status of organizations making donations to "subversive" organizations or individuals (100 Cong. Rec. 9,446 (July 1, 1954). As Mr. Silverstein stated: "A close reading of the Congressional Record of that week would seem to imply that anti-communist sentiment was high pitched at the time, prompted especially by discussion of the proposed admission of Communist China to the United Nations, as well as of left-wing subversive activities in Guatemala."

However, it is not simply the temper of the moment that gives credence to Mr. Silverstein's theory. McCarran was a Senator of enormous influence. Former Chairman of the Judiciary Committee and of its Internal Security Subcommittee (and ranking minority member after the Republicans obtained control of the Senate in 1953), author of the Internal Security Act of 1950 and the McCarran-Walter Immigration Act, his political positions were quite different from Johnson's -- McCarran once explained he remained a Democrat because "I can do more good by staying in the Democratic Party and watching the lunatic fringe -- the Roosevelt crowd."[45] Nevertheless, Johnson had sometimes sided with McCarran, for example, he had voted to override President Truman's vetoes of both the Internal Security Act of 1950 and the McCarran-Walter Immigration Act. Furthermore, in 1954, Johnson's was somewhat in McCarran's debt -- during the primary campaign Johnson asked McCarran for a letter praising Johnson's "staunch Americanism." Robert Dallek, Lone Star Rising, (1991) 450. Nevertheless, as Minority Leader, Johnson's strategy has been described as "promoting party unity and bipartisanship at the same time." Id. at 447. Allowing passage of McCarran's amendment contravened that strategy.

Furthermore, there is every evidence that McCarran's proposed amendment was a serious effort. It was not the Senator's first foray into the world of exempt organizations. As previously mentioned, McCarran authored the Internal Security Act of 1950, and § 11(b) of that Act denied exemption to any organization registered under the Act as a Communist-action or Communist-front organization. Pub. L. 81-831, reprinted in 1950-2 C.B. 250, 252. The proposed bill went much further -- it would have denied exemption to organizations making donations not only to organizations covered under the 1950 Act but to other "subversive organizations" or to an individual that was a member of a "subversive organization." McCarran explained the provision at length, arguing for its constitutionality although not touching on its administrability, furnishing ample evidence that passage was intended. 100 Cong. Rec. 9,447 (July 1, 1954).

Given these contexts, Mr. Silverstein's theory, that Johnson's amendment was an exercise in circumspection (although one with far-reaching effects), has considerable appeal. This, however,

[45] For a description of Senator McCarran, see Alfred Steinberg, "McCarran: Lone Wolf of the Senate," Harper's, Nov. 1950, at 87.

is not to deny the attractiveness of the hypotheses of Mr. Hopkins, Mr. Lehrfeld, or the USCC.[46] Perhaps all four are true; nothing is certain.

[46]This would not be the first instance of a the impetus for a Code provision being an exempt organization's opposition to a legislator. It is evident that, in 1934, the apparent sponsor of the limitation on lobbying activities, Senator David Reed, was aiming at an exempt organization, the National Economy League, that was opposing legislation that he was making the centerpiece of his primary campaign for renomination as the Republican candidate for Senator from Pennsylvania. See the discussion of the 1934 enactment of the limitation on the lobbying activities of charities, 1997 CPE Text, 264-266.

## APPENDIX II

## The Political Campaign Prohibition *vis a vis* the Restriction on Private Benefit The American Campaign Academy and Coalition for Freedom Cases

A. Introduction

As discussed in the text, an organization will not qualify as an IRC 501(c)(3) organization if it participates in a political campaign. However, it must meet all of the requirements under IRC 501(c)(3) in order to qualify for tax exemption. In particular, the organization must be operated for the benefit of the public, rather than for private interests, which could include political entities.

B. Private Benefit Cases

(1) *American Campaign Academy*

In American Campaign Academy v. Commissioner, 92 T.C. 1053 (1989), the court held that an organization formed to operate a school to train individuals for careers as political campaign professionals did not qualify as an organization described in IRC 501(c)(3) because it was operated primarily for the private benefit of Republican entities and candidates. In the case, the issue raised by the Service and addressed by the court was not whether the American Campaign Academy (the Academy) had participated or intervened in a political campaign on behalf of, or in opposition to, any candidate for public office. Rather, the issue was whether a private interest was being served so that the Academy was not described in IRC 501(c)(3). The lessons to be gleaned from American Campaign Academy are as follows:

(1) The fact that an organization's activities may be described as educational will not sustain exemption if more than insubstantial private benefit is present.

(2) Failure to provide information need not consist of an outright refusal. If the information is relevant, the organization may be required to produce a concrete and responsive answer. Where other evidence indicates that private benefit exists, a failure to substantively respond on certain factual points may justify a finding that the facts being avoided would be detrimental to the organization.

Neither of these principles were novel at the time of the American Campaign Academy decision and neither have any peculiar application to organizations involved with political advocacy. However, in view of the persistent notion that American Campaign Academy is somehow a stealth political campaign prohibition case, its facts, its resolution, and where it fits within the penumbra of IRC 501(c)(3) analysis are set forth in considerable detail below.

As its primary activity, the Academy operated a school to train individuals for careers as campaign managers, communications directors, finance directors, and other professionals involved

in the running of a political campaign. The Academy had several secondary purposes including sponsoring research and publishing instructional materials, reports, newsletters, pamphlets or books relating to the conduct of political campaigns. (These activities were ancillary to the operation of the school; the research and publications were normally used in the Academy's classes.) The Academy also engaged in some public opinion research and polling on political issues and attempts to elevate the standards of professionalism, ethics, and morality in the conduct of political campaigns.

In most respects, the Academy operated as a traditional school on a single subject with a faculty experienced in the various subjects relating to the operation of a political campaign. The Tax Court noted that similar campaign management courses were offered by various colleges and universities, as well as other organizations. The Academy, therefore, would be described in IRC 501(c)(3) so long as it served a public interest as required by Reg. 1.501(c)(3)-1(d)(1)(ii) and did not violate the IRC 501(c)(3) political campaign prohibition.

The Tax Court noted that the Academy did not train candidates nor participate in, nor intervene in, any political campaign on behalf of any candidate and that the government did not assert that the Academy was involved in any proscribed campaign activities. Id. at 1055, 1063. Therefore, since the Academy manifestly was an educational institution, and since it did not violate the political campaign prohibition, what was the problem?

The problem was that the Academy failed to establish that it was operated exclusively for exempt purposes as required by IRC 501(c)(3); instead, the factual record disclosed that the Academy was operated for the benefit of a private interest (in this case, Republican entities and candidates) rather than for a public purpose. The case was simply an evidentiary matter.

The Academy's application for recognition of exemption under IRC 501(c)(3) disclosed that it was an outgrowth of programs formerly sponsored by the National Republican Congressional Committee (NRCC), the NRCC contributed assets to the Academy; some of the faculty were previously involved in the NRCC training program and one its three initial directors was the executive director of the NRCC. The Academy instituted a curriculum that included studies of "Growth of NRCC, etc." and "Why are people Republicans."[47] The Academy's newsletters reported on the activities of 119 of its 120 graduates -- 85 participated in Congressional or Senatorial campaigns, four were employed by the NRCC or Republican National Committee Field Divisions, 10 graduates participated in the State or local campaigns or were employed by State Republican parties, and several worked as political consultants. In all cases in which the Service was able to identify the party affiliation of the organization that the graduates worked for, the party affiliation

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[47] The Tax Court made the following observation:

> *Following the reorganization of petitioner's curriculum after the 1986 election, additional partisan topics such as "Other Republican givers lists," "How some Republicans have won Black votes," and "NRCC/RNC/State Party naughtiness" were added. The academy's curriculum failed to counterbalance the Republican party focus of these courses with comparable studies of Democratic or other political parties.* Id. at 1070-1071.

was Republican. Consequently, when the Service requested the Academy to provide additional information regarding its application for recognition of exemption, it specifically requested the Academy to identify how many of its graduates worked for Republican, how many worked for Democratic, and how many worked for other party candidates or organizations. As the Tax Court noted, the Academy replied as follows:

> *We do not require students to remain in contact with the Academy following graduation. Of those who chose to do so, some have informed the Academy of the identity of the candidate(s) for whom they are working. (See the [attached] newsletters *** .) To the best that can be determined, the predominant party affiliation of the candidates for whom Academy graduates are working in 1986 are Republican, but the Academy has no exact numbers.* Id. at 1061.

The Tax Court treated this response as the equivalent of an admission that no organizations other than Republican organizations were served by the Academy's graduates, as demonstrated by the court's comment:

> *A showing that petitioner's graduates served in Congressional and Senatorial campaigns of candidates from both major political parties in substantial numbers would have significantly aided petitioner's contention that its activities only benefitted nonselect members of a charitable class. Nevertheless, petitioner did not see fit to include in the administrative record any specific example of a graduate working for a Democratic Senatorial or Congressional candidate. We cannot assume that information regarding the placement of academy graduates, not shown to be unavailable, would have been favorable to petitioner; i.e., would have reflected nonpartisan placement. In fact, the contrary is true. See Fear v. Commissioner, T.C. Memo. 1989-211; see also Wichita Terminal Elevator Co. v. Commissioner, 6 T.C. 1158 (1946), affd. 162 F.2d 513 (10th Cir. 1947). Consequently, it is reasonable to infer from petitioner's omission that the affiliation information, had it been included, would have revealed the Republican affiliation of the candidates.*[48]
>
> *Based upon our review of the administrative record, we find that petitioner operated to advance Republican interests. We also find that placement of 85 of petitioner's graduates in the campaigns of 98 Republican Senatorial and Congressional candidates conferred a benefit on those candidates. Petitioner's partisan purpose*

[48] The court's conclusion that the Academy had intentionally avoided providing the information requested was based on the fact that the Academy included the study of FEC rules and regulations in its curriculum. Therefore,

> *[P]etitioner would have to concede that it is peculiarly positioned to have knowledge and awareness of the ready availability of data from the Commissioner's public records. Accordingly, we infer that petitioner's "best determination" regarding the predominant Republican party affiliation of the candidates for whom Academy graduates were working in 1986 reflects the political affiliations disclosed in the Federal Election Commission's public records.* Id. at 1072.

> *distinguishes the case at bar from Rev. Rul. 76-456.*[49] *Likewise, petitioner's partisan purpose differs significantly from the nonpartisan educational purpose served by a university through means of a political science course which required each student to participate in a two-week period in the political campaign of a candidate of his or her choice. See Rev. Rul. 72-512, 1972-2 C.B. 246.* Id. at 1072-1073.

Accordingly, the Academy's service of the private interest of Republican entities and candidates makes its situation distinguishable from IRC 501(c)(3) training schools that have been determined to be described in IRC 501(c)(3), such as those described in Rev. Rul. 67-72, 1967-1 C.B. 125 (labor and management operated, industry wide training program including classroom and on-the-job training); Rev. Rul. 68-504, 1968-2 C.B. 211 (organization conducted courses on various banking subjects open to employees of all banks in the urban area); and Rev. Rul. 72-101, 1972-1 C.B. 144 (organization created as a result of collective bargaining agreements trained individuals working or desiring work in a particular industry.) In all three rulings there was an emphasis on the industry-wide basis of the program. None of the programs were organized, operated, or influenced by any particular business corporation, but rather served the public by providing training on a broad basis.[50] This contrasts with the Academy, which was funded by an organization (in this case, a Republican entity) that both dominated the officers and selection process and became the seemingly sole employer of its graduates.

On numerous other occasions, both the Service and the courts have concluded that an organization the engages in an acknowledged educational activity, like the Academy, is not described in IRC 501(c)(3) if it serves private interests on more than an insubstantial basis. See The Callaway Family Association, Inc. v. Commissioner, 71 T.C. 340 (1978), and Manning Association v. Commissioner, 93 T.C. 596 (1989) (organizations engaged in researching the genealogy of a family) wherein each court observed "petitioner was not denied exemption because it had no exempt purposes, but rather because its activities, taken as a whole, are not exclusively dedicated to exempt purposes" (71 T.C. at 341, quoted in 93 T.C. at 611); See also Rev. Rul. 74-116, 1974-1 C.B. 127 (organization keeping members informed of current scientific and technical data with respect to a specific type of computer is not described in IRC 501(c)(3)).

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[49] Rev. Rul. 76-456, 1976-2 C.B. 151, holds that an organization formed to elevate the standards of ethics and morality in the conduct of political campaigns that disseminates information concerning general campaign practices, furnishes teaching aids to political science and civics teachers, and publicizes its proposed code of fair campaign practices without soliciting the signing or endorsement of the code by candidates qualifies as an educational organization under IRC 501(c)(3). The revenue ruling, emphasizing the organization's nonpartisan nature (as well as the fact that it did not solicit the signing or endorsement of its code of fair campaign practices by candidates for political office), concluded that the organization exclusively served a public purpose by increasing citizens' knowledge and understanding of election processes. As the court noted on page 1069, the Academy argued that the revenue ruling prescribed the proper characterization of all benefits conferred by organizations engages in such activities.

[50] In a sense, all training of students serves an incidental private benefit to both the student in increased future earnings and the eventual employer who benefits from the services of the trained individual. There is a distinction, however, where the private benefit served is incidental to the overriding public benefit in education and training and training focused on the private benefit of one interest.

A summary review of all the above cited materials should not lead one to conclude that a school to train campaign workers cannot be described in IRC 501(c)(3). The American Campaign Academy's conclusion that a private interest is being served more than incidentally is based on the particular facts of the case including the Academy's funding, its assumption of some Republican party training, the composition of its admission panels, the content of its courses, the composition of its Board of Directors and faculty, and the subsequent employment of its graduates. For a thorough discussion of private benefit in the educational context, see G.C.M. 39716 (Mar. 29, 1988).

(2) *Coalition for Freedom*

In American Campaign Academy, an organization failed to qualify as an organization described in IRC 501(c)(3) because, although its activities did not constitute prohibited political campaign intervention, its method of operation conferred a substantial private benefit on another organization, which happened to be a political party. In Coalition for Freedom, different activities gave rise to adverse conclusions under IRC 501(c)(3) with respect to private benefit (and inurement) as well as political campaign intervention.

On December 20, 1994, in a stipulated decision, the Tax Court upheld the Service's revocation of the exempt status of Coalition for Freedom, Inc., (CFF) as an organization described in IRC 501(c)(3). Coalition for Freedom, Inc. v. Commissioner, Docket No. 5406-93X.[51] In an unpublished technical advice memorandum that was attached to CFF's Tax Court petition, the Service concluded that revocation of the CFF's IRC 501(c)(3) status was appropriate for the following reasons:

1. CFF served a private rather than a public interest under Reg. 1.501(c)(3)-1(d)(1)(ii) due to the nature of its payments to non-IRC 501(c)(3) organizations (and their employees and consultants).

2. To the extent that these amounts inured to the benefit of "insiders" of CFF, they also constituted inurement.

3. The various payments to, and affiliation with, political organizations and other non-IRC 501(c)(3) organizations and individuals that worked with and for political organizations constituted political campaign intervention.

Coalition for Freedom, Inc. Petition for Declaratory Judgment, reprinted in 7 Exempt Organizations Tax Review 1005 (June 1993).

CFF was part of a large network of organizations controlled by the same individuals. CFF's ostensible role was to produce and disseminate educational materials related to foreign policy issues, bias in the media, the impact of welfare programs on minorities, and other similar activities. The network of organizations generally performed activities supportive of political positions and political

[51] The Tax Court's stipulated decision stated that revocation did not prejudice CFF's right to seek IRC 501(c)(3) status after 1992 nor to litigate post-1992 adverse determinations regarding exempt status.

candidates for public office. In addition to CFF, the individuals controlled two other organizations that had been recognized as exempt as organizations described in IRC 501(c)(4) and an unincorporated political action committee, National Congressional Club (NCC). They also controlled Education Support Foundation, Inc. (ESF), which had an application pending for recognition of its status as an organization described in IRC 501(c)(4). ESF owned all of the stock of Jefferson Marketing, Inc. (JMI), a for-profit corporation, whose main activity involved campaign related political consulting and other activities supportive of political campaigns. JMI had seven wholly-owned for-profit subsidiaries that supported its activities.

The technical advice memorandum analyzed the activities of CFF and the other organizations in the network during the years at issue. It determined that CFF engaged in a number of fundraising activities seeking tax-deductible contributions for a variety of projects, most of which never materialized. Instead, most of the money raised was used to pay fees and expenses to JMI, its taxable subsidiaries, and to individuals employed by those entities.

In a suit filed by the FEC alleging that ESF and NCC were in fact one organization, the FEC argued that two of the three members of CFF's Board controlled both ESF and NCC (as well as JMI due to ESF's ownership of JMI) and that JMI was providing services to NCC and other political clients for less than fair market value. The funds provided by CFF enabled JMI and its subsidiaries to engage in activities for its political clients at less than fair market value. In additional, the funds enabled JMI and its subsidiaries to provide services to political clients who were known to be unable or unexpected to pay their full bills timely, particularly Funderburk for Senate (FFS), the political campaign committee of former Ambassador David Funderburk.

CFF paid consulting fees to individuals who were heavily involved in the FFS campaign along with other political campaign activities of JMI and NCC. The individuals paid appeared to be spending all their time on non-CFF political activities during periods when they were being paid consulting fees by CFF. CFF also hired Mr. Funderburk after his unsuccessful campaign. He was paid a monthly consulting fee, although the only work done on the project for which he was hired was done by JMI (for which JMI was also paid).

CFF engaged in a joint fundraising event with NCC and sponsored an event featuring three Presidential candidates whose views coincided with those of CFF. There was no indication that CFF took any steps to ensure that it conducted these events in a neutral manner with respect to the campaign.

The technical advice memorandum stated that the benefits flowing from CFF to JMI, its subsidiaries, and the individuals showed that CFF was operated for the substantial non-exempt purpose of serving those private interests rather than operating for the benefit of the public. In addition, the flow of funds to the benefit of the insiders of CFF constituted inurement. Finally, the technical advice memorandum noted that the interrelated structure of the organizations and the flow of benefits from CFF to support the political activities of JMI and its subsidiaries created a situation where CFF was engaging in prohibited political campaign activity.

C. Conclusion

As illustrated by these cases, an organization that is operated for the benefit of private parties, including political entities, rather than for the benefit of the public will not qualify as an IRC 501(c)(3) organization. Whether the organization has also violated the political campaign prohibition depends upon all of the relevant facts and circumstances.

## APPENDIX III

## The New Reporting and Disclosure Regime for IRC 527 Organizations

A. The "New Section 527 Organizations"

> *[T]he terms "partisan electoral politics" and "electioneering" raise virtually the same vagueness concerns as the language "influencing any election for Federal office," the raw application of which the Buckley court determined would impermissibly impinge on First Amendment values....*
>
> *Confining the definition of "political committee" to an organization whose major purpose is the election of a particular federal candidate or candidates provides an appropriate "bright-line" rule; attempting to determine what is an "issue advocacy" group versus an "electoral politics" group-as the Commission proposes-does not.* Federal Election Commission v. GOPAC, 917 F.Supp. 851, 861 (D.D.C. 1996)

The GOPAC decision illustrates the differences between qualifying as a "political committee" under the FECA and qualifying as a "political organization" under IRC 527 -- under the FECA, the GOPAC decision tells us it is inappropriate to make a determination on the basis of issue advocacy versus electoral politics; under IRC 527, as will be described below, the Service examines all facts and circumstances to determine if there is a sufficient nexus between the activity and the election of an individual to public office.

Considerable consequences result from the distinct treatment that an organization might receive under the two statutory regimes. The FECA requires political committees to register and file periodic reports with the FEC disclosing the funds they raise and spend. 2 U.S.C. § 431(17), § 433, and § 434. Until July 1, 2000, IRC 527 had no information reporting requirements. As Joseph Mikrut, Treasury Tax Legislative Counsel, testified before the Oversight Subcommittee of the House Committee on Ways and Means, June 20, 2000:

> *Although some uncertainty remains, the current prevailing view of the courts appears to be that, in the absence of coordination with a candidate's campaign, only communications that contain express words advocating the election or defeat of a candidate-such as "vote for," "support," "defeat," and certain other "magic words"-are subject to the requirement of the FECA, including the restrictions on contributors eligible to fund such communications, the contribution limits, and public disclosure requirements for funds raised and spent on such communications. Accordingly, individuals, entities, and groups-including section 527 political organizations-that attempt to influence Federal elections, but that refrain from "express advocacy," may be able to avoid the FECA reporting and disclosure requirements.* (Footnotes omitted.)[52]

[52] Mr. Mikrut's testimony is reprinted in 5 Paul Streckfus' EO Tax Journal 220 (June 2000).

To take advantage of this situation, a type of campaign finance vehicle, dubbed a "new section 527 organization," or "soft PAC" has surfaced.[53] Essentially, as Mr. Mikrut's testimony notes, organizations could qualify for IRC 527 treatment because they attempt to influence the election of individuals to public office; at the same time, they would argue they were not subject to the reporting or disclosure requirements under the FECA because they do not engage in express advocacy within the scope of the FECA.

What is "new" about these organizations requires some clarification. They are not "new" in any theoretical sense. Since the IRC 527(e)'s definition of "exempt function" is broad and IRC 527(a) permits an organization that makes indirect expenditures for an exempt function to qualify for tax-exempt treatment, organizations with a more remote nexus between their activities and the election of an individual to public office have qualified as a political organization under IRC 527. (For example, as noted in the text, a 1983 G.C.M. (39178) concludes that an organization formed and controlled by a political organization to construct, own, and operate a building to house the political organization's headquarters qualifies for IRC 527 status.) Furthermore, for purposes of IRC 527, expenditures need not be related to a particular candidate's campaign, but may relate to attempts to influence voting on multiple (announced or unannounced) candidates. As noted in Reg. 1.527-2(c)(5)(viii), Example 8:

> *Q is an organization described in section 527(e)(2). Q finances seminars and conferences which are intended to influence persons who attend to support individuals to public office whose political philosophy is in harmony with the political philosophy of Q. The expenditures for these activates are for an exempt function.*

Consequently, since the enactment of IRC 527, should an organization constructed in such a manner requested a ruling that it qualified for IRC 527 treatment, it would have received a favorable answer. However, no such ruling was requested and none was issued until December 27, 1996.

The December 27, 1996 ruling, PLR 96-50-026, concerned a separate segregated fund established by an IRC 501(c)(4) organization. According to the document that established the fund, the fund was prohibited from engaging in express advocacy activities that would trigger the reporting and disclosure requirements of the FECA; instead, it would engage in distribution of voters' guides that would constitute prohibited political intervention for an IRC 501(c)(3) organization. The fund's description of its activities tracked the description of voters' guides set forth in Rev. Rul. 78-248, 1978-1 C.B. 154, and Rev. Rul 80-282, 1980-2 C.B. 178., which set forth facts and circumstances to be considered in determining whether these activates jeopardized IRC 501(c)(3) status. Favorable

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[53] The term "new section 527 organization" first appeared in Frances R. Hill's extended discussion of the phenomenon, "Probing the Limits of Section 527 To Design a New Campaign Finance Vehicle," 26 Exempt Organization Tax Review 205. The term "soft PAC," which connotes that the organization does not receive "hard money" contributions that are subject to the FECA rules, is found in a discussion paper by Rosemary E. Fei, "The Uses of Section 527 Political Organizations," Structuring the Inquiry into Advocacy Vol. 1 23, Urban Institute (2000) (hereinafter Fei 2000).

factors for IRC 501(c)(3) status, for example, wide distribution, were rejected; unfavorable ones, for example, targeting distribution toward particular areas and "bias," were adopted. Therefore, in concluding that the fund's activities qualified for IRC 527 treatment, PLR 96-50-026 stated as follows:

> *Rev. Ruls. 78-248 and 80-282 address the facts and circumstances that are relevant to determining when voting records and voter guides cross the line from simply educating voters to influencing or attempting to influence their votes in the context of section 501(c)(3)'s prohibition on participation or intervention in a political campaign on behalf of or in opposition to a candidate. But they also may be used to indicate the types of voter guides and voting records that would qualify as an exempt function activity under section 527(e)(2). Since the 501(c)(3) prohibition is also based on a "facts and circumstances" test, the rulings provide guidance as to the important factors to consider.*
>
> ****
>
> *Based on the factors identified in the revenue rulings, the Fund's voter guides and voting records would be prohibited political intervention for a section 501(c)(3) organization and are, correspondingly, for an exempt function within the meaning of section 527 (e)(2). While the guides may not meet all of the factors, any one guide meets enough of the factors so that distribution of the guide can be said to be an exempt function activity within the meaning of section 527(e)(2).*

The issuance of PLR 96-52-026 (Oct. 1, 1996) marked a watershed. As Ms. Fei has noted: "While it may already have been clear to the IRS, tax lawyers up to this point had not been sure exactly how far Section 527's exempt function reached in practice." Fei 2000, 26. In three subsequent private letter rulings the Service recognized the IRC 527 status of organizations that were expressly prohibited from expressly advocating the election or defeat of any candidate but that expressly avowed their voter education activities would be biased to influence election campaigns. PLR 97-25-036 (Mar. 24, 1997); PLR 98-08-037 (Nov. 21, 1997); PLR 1999-25-051 (Mar. 29, 1999). The effect of these rulings' issuance has been described as follows:

> *Tax lawyers' recent "discovery" of just how much broader was the IRS's tax law definition of political activities under Section 527 than that set forth by any election commission gave election lawyers just the opening they needed. Advocates found ample room to design programs to influence election outcomes without express advocacy of any candidate's election or defeat - independent of any candidate, party, or registered political action committee - and conduct these programs free of regulation under any election law, using a 527 political organization.* Fei 2000, 28.

The emergence of these organizations resulted in legislative proposals to amend IRC 527; a hearing held by the Subcommittee on Oversight of the House Committee of Ways and Means, June 19, 2000; and ultimately passage of Public Law 106-230, which, as noted above, was signed by President Clinton on July 1, 2000.

B. Public Law 106-230

On July 1, 2000, Public Law 106-230 was enacted, amending IRC 527. The new law, which became effective immediately, created a reporting regime for IRC 527 organizations. The new law requires IRC 527 organizations to provide a notice of status, periodically report contributions and expenditures, and file annual information returns as well as tax returns. The new law does not affect any period prior to July 1, 2000. Prior law with respect to IRC 527 status is unchanged. The following revenue ruling, released October 12, 2000 (see IR-2000-71, Oct. 12, 2000), concerns the reporting requirements created under the new law.

Rev. Rul. 2000-49, 2000-44 I.R.B. 430, Oct. 30, 2000
ISSUES

On July 1, 2000, Pub. L. 106-230 was enacted, amending § 527 of the Code. The new law imposes three reporting and disclosure requirements on political organizations described in § 527: (1) an initial notice of status, (2) periodic reports of contributions and expenditures, and (3) annual returns. This revenue ruling provides questions and answers relating to the reporting and disclosure requirements for political organizations described in § 527.

QUESTIONS AND ANSWERS

I. Notice of Status

1. Q. What is the notice of status requirement for an organization described in § 527?

A. Under § 527(i)(1)(A), a political organization is required to give notice both electronically and in writing to the Service that it is a political organization described in § 527.

2. Q. What is the required notice form?

A. The required notice form is Form 8871, *Political Organization Notice of Section 527 Status*.

3. Q. Are all political organizations required to file the Form 8871 notice?

A. No. Under § 527(i)(5) and § 527(i)(6), three types of organizations are not required to file the Form 8871 notice:

(a) Persons required to report under the Federal Election Campaign Act of 1971 (FECA) as a political committee (see 2 U.S.C. § 431(4));

(b) Organizations that reasonably anticipate that their annual gross receipts will always be less than $25,000; and

(c) Organizations described in § 501(c) that are subject to § 527(f)(1) because they have made an "exempt function" expenditure.

All other political organizations, including state and local candidate committees, are required to file the notice.

4. Q. Is a political organization required to file Form 8871 if it does not know whether it will have annual gross receipts of $25,000 or more for any taxable year?

A. A newly established political organization is not required to file Form 8871 if it reasonably anticipates that its annual gross receipts will be less than $25,000 for its first six taxable

years. However, if an organization, in fact, does have annual gross receipts of $25,000 or more for any taxable year, it is required to file Form 8871 within 30 days of receiving $25,000.

5. Q. Is the separate segregated fund established under § 527(f)(3) by a § 501(c) organization required to file Form 8871?

A. A § 501(c) organization that is not prohibited from participating in political campaign activity has the option of conducting the activity itself or setting up a separate segregated fund. If the § 501(c) organization conducts the activity itself, it is subject to tax under § 527(f)(1) on the lesser of its investment income or the amount of its political expenditures, but it is not required to file Form 8871 pursuant to § 527(i)(5)(A). If the § 501(c) organization establishes a separate segregated fund, the fund is treated as a separate political organization under § 527(f)(3) and does not qualify for the exception under § 527(i)(5)(A). Therefore, unless it meets one of the other exceptions, the separate segregated fund is required to file Form 8871.

6. Q. Is an organization that finances both federal and non-federal election activity required to file the Form 8871 notice?

A. As a general rule, any political organization (whether or not separately incorporated) that is organized and operated primarily for an exempt function under § 527(e)(2) (see Q&A-17) must file Form 8871 unless it meets one of the exceptions discussed above (see Q&A-3), one of which is being required to report under FECA as a political committee. An organization that finances election activity (within the meaning of FECA) for both federal and non-federal elections may establish a political committee to receive contributions and make expenditures for both federal and non-federal election activity. In that case, the organization must register as a political committee and comply with the FECA contribution limitations and reporting requirements. 11 C.F.R. § 102.5(a)(1)(ii). Such an organization is, therefore, not required to file Form 8871.

If, however, the organization sets up separate accounts to conduct its federal election activity and its non-federal election activity, the federal account is treated as a separate political committee that is required to register and report under FECA. 11 C.F.R. § 102.5(a)(1)(i). The treatment of the federal account as a separate committee is consistent with the organizational requirements for political organizations under § 527, as discussed below in Q&A-12. Accordingly, the separate federal account is not required to file Form 8871. However, a separate non-federal account is not required to register and report under FECA as a political committee. Therefore, a separate non-federal account that is described in § 527(e)(1) is required to file Form 8871.

7. Q. Are political organizations that are required to report to state or local election agencies excepted from the notice requirement?

A. Section 527(i) does not except political organizations that file reports with state or local election agencies from the notice of status requirement. Therefore, unless the political organization meets one of the exceptions discussed above in Q&A-3, it must file Form 8871 with the Service.

8. Q. When must the organization file Form 8871?

A. Form 8871 must be filed within 24 hours after the date on which the organization was established. See Notice 2000-36, 2000-33 I.R.B. 173 for information about filing requirements for organizations in existence before July 30, 2000.

9. Q. What are the methods of filing Form 8871?

A. Section 527(i)(1)(A) requires that the organization file Form 8871 both electronically and in writing. Therefore, the methods for filing Form 8871 are as follows:

(a) Electronically via the Internal Revenue Service Internet Web Site (IRS Web Site) at www.irs.gov./polorgs, and

(b) In writing by sending a signed copy of Form 8871 to the Internal Revenue Service Center, Ogden, UT 84201. An organization can fill in and print out the form from the IRS Web Site.

10. Q. Must an organization take any additional steps before filing Form 8871?

A. Before filing Form 8871, the political organization must have its own employer identification number (EIN) even if it has no employees. To obtain an EIN, an organization must file Form SS-4, *Application for Employer Identification Number*, with the Service (see Q&A-52).

11. Q. What information must be provided in the Form 8871 notice?

A. Under § 527(i)(3), an organization must provide in its Form 8871 notice its name and address (including any business address, if different) and electronic mailing address; its purpose; the names and addresses of its officers, highly compensated employees, contact person, custodian of records, and members of its Board of Directors; and the name and address of, and relationship to, any related entities (within the meaning of § 168(h)(4)).

12. Q. Does § 527(i) change the organizational requirements for § 527 organizations?

A. No. Section 527 does not require an organization to have formal organizational documents, such as articles of incorporation. Under § 1.527-2(a)(2) of the Income Tax Regulations, a political organization meets the organizational test if it is organized for the primary purpose of carrying on exempt function activities as defined in § 527. The regulation specifically states that the organization need not be formally chartered or established as a corporation, trust, or association. For example, a separate bank account can qualify as a political organization. See Rev. Rul. 79-11, 1979-1 C.B. 207.

The requirement that a § 527 organization include the names and addresses of its officers, highly compensated employees, and members of its Board of Directors does not change the organizational test for § 527. Section 527(i) does not require political organizations to be organized with Boards of Directors, officers and highly compensated employees. It merely requires the organization to provide their names and addresses if it is so organized.

13. Q. What is a "related entity" for this purpose?

A. An entity is a "related entity" within the meaning of § 168(h)(4), which provides that an organization is related to another entity as follows:

(a) The two entities have (i) significant common purposes and substantial common membership or (ii) directly or indirectly substantial common direction or control; or

(b) Either entity owns (directly or through one or more entities) a 50 percent or greater interest in the capital or profits of the other. For this purpose, entities treated as related entities under (a) above shall be treated as one entity.

14. Q. What are "highly compensated employees" for this purpose?

A. Highly compensated employees for this purpose are the five employees (other than officers and directors) who are reasonably expected to have the highest annual compensation over $50,000. Compensation includes both cash and noncash amounts, whether paid currently or deferred, for the 12-month period that began with the date the organization was formed (if the organization was formed after June 30, 2000). If the organization was already in existence on June 30, 2000, it must use the accounting period that includes July 1, 2000.

15. Q. What if an organization described in § 527(e)(1) does not file the Form 8871 notice?

A. An organization described in § 527(e)(1) must file Form 8871 unless it is an organization described in § 527(i)(5) or § 527(i)(6) (see Q&A-3). If the organization fails to file Form 8871 on a timely basis, § 527(i)(4) provides that until the organization satisfies the notice requirement, the taxable income of the organization includes its exempt function income (including contributions received, membership dues, and political fundraising receipts), minus any deductions directly connected with the production of that income. For purposes of computing its taxable income, the organization may not deduct its exempt function expenditures because § 162(e) denies a deduction for political campaign expenditures.

Under § 527(b), the tax is computed by multiplying the organization's taxable income (including its net investment income) by the highest corporate tax rate, currently 35 percent. The organization must file a Form 1120-POL to report the income and pay the tax.

16. Q. When is an organization described in § 527(e)(1)?

A. An organization is described in § 527(e)(1) if it meets both the organizational and operational tests, that is, it must be organized and operated primarily for the purpose of accepting contributions or making expenditures for an exempt function under § 527(e)(2). See § 1.527-2(a).

17. Q. What is an "exempt function" under § 527(e)(2)?

A. "Exempt function" means, under § 527(e)(2), influencing or attempting to influence the selection, nomination, election, or appointment of any individual to any federal, state, or local public office or office in a political organization, or the election of Presidential or Vice-Presidential electors, whether or not such individual or electors are selected, nominated, elected, or appointed.

18. Q. Are transfers to political organizations that fail to file Form 8871 subject to the gift tax?

A. Section 2501(a)(5) provides that the gift tax does not apply to transfers of money or other property to political organizations within the meaning of § 527(e)(1). Therefore, transfers to an organization described in § 527(e)(1) (see Q&A-16) are not subject to the gift tax, regardless of whether the organization has filed Form 8871.

19. Q. Is the Form 8871 notice publicly available?

A. Yes. Under § 6104(a), Form 8871 (including any supporting papers), and any letter or other document the Service issues with regard to Form 8871, will be open to public inspection. Copies of Form 8871 that have been filed are currently available at the IRS Web Site at www.irs.gov/polorgs and are considered widely available under § 301.6104(d)-3 of the Procedure and Administration Regulations, as long as the organization provides the IRS Web Site address to the person making the request. In addition, the organization is required to make a copy of these materials available for public inspection during regular business hours at the organization's principal office (and at each of its regional or district offices having at least three paid employees) in the same manner as applications for exemption of § 501(c) organizations are made available. § 6104(d).

20. Q. What is the penalty on the organization for failure to comply with the public inspection requirement?

A. Under § 6652(c)(1)(D), a penalty of $20 per day may be imposed on any person with a duty to comply with the public inspection requirement for each day a failure to comply continues.

II. Periodic Reporting Requirements

21. Q. What are the periodic reporting requirements imposed upon political organizations?

A. Under § 527(j), a political organization is required to periodically report certain contributions it receives and expenditures it makes.

22. Q. What is the required periodic reporting form?

A. The required periodic reporting form is Form 8872, *Political Organization Report of Contributions and Expenditures*.

23. Q. When are political organizations required to file periodic reports on Form 8872?

A. Under § 527(j)(2), political organizations that accept contributions or make expenditures for an exempt function under § 527 (see Q&A-17) during a calendar year are required to file periodic reports on Form 8872, beginning with the first month or quarter in which they accept contributions or make expenditures. In addition, organizations that make contributions or expenditures with respect to an election for federal office (as defined in § 527(j)(6)) may be required to file pre-election reports for that election.

24. Q. Are all political organizations required to file periodic reports on Form 8872?

A. No, § 527(j)(5) provides that some organizations are not subject to this requirement. The organizations excepted from the filing requirements are as follows:

(a) Organizations excepted from the requirement to file a Form 8871 (see Q&A-3);

(b) Political committees of a state or local candidate, including political committees of state or local officeholders; and

(c) State and local committees of political parties.

All other political organizations, including state and local political action committees, are subject to the reporting requirements of § 527(j), even if they file reports with state or local election agencies.

25. Q. Must a state or local candidate or officeholder organize a formal committee to be excepted from the Form 8872 filing requirements?

A. No. As discussed in Q&A-12, § 527 does not require organizations to have formal organizational documents. Therefore, a candidate or officeholder does not need to organize a formal committee to qualify for the exception under § 527(j)(5) for committees of state or local candidates.

26. Q. Are political organizations that engage in exempt function activities (as defined in § 527(e)(2)) solely with respect to elections for state or local offices excepted from the Form 8872 filing requirements?

A. No. Although the timing of the reports is based upon federal elections (see Q&A-34), the requirement to file the reports is based on accepting contributions or making expenditures for an exempt function under § 527(e)(2) (see Q&A-17). Therefore, unless a political organization meets one of the exceptions discussed above in Q&A-24, it must file Form 8872 with the Service.

27. Q. Is an organization that reasonably anticipated it would not have annual gross receipts of $25,000 or more required to file Form 8872 if it, in fact, receives $25,000 or more in any taxable year?

A. An organization that receives $25,000 in any taxable year no longer qualifies for the exception in § 527(j)(5)(C) and, therefore, must begin filing Form 8872 unless it meets one of the other exceptions discussed in Q&A-24. The organization must file, within 30 days of receiving $25,000, any Form 8872 that would otherwise have been due during the calendar year prior to that date.

28. Q. How often must the Form 8872 be filed?

A. A political organization subject to the periodic reporting requirement may choose to file Form 8872 on a monthly basis or on a quarterly/semi-annual basis, but it must file on the same basis for the entire calendar year.

29. Q. What is an election year and non-election year for purposes of determining the due dates for filing Form 8872?

A. An election year is any year in which a regularly scheduled general election for federal office is held, i.e., any even-numbered year. A non-election year is therefore any odd-numbered year.

30. Q. If an organization chooses to file on a monthly basis, when is Form 8872 due in a non-election year?

A. Pursuant to § 527(j)(2)(B), a political organization that chooses to file monthly must file Form 8872 reports not later than the 20th day after the end of the month, which must be complete as of the last day of the month. December activity is included in the year-end report which is due not later than January 31 of the following year.

31. Q. If an organization chooses to file on a monthly basis, when is Form 8872 due during an election year?

A. Pursuant to § 527(j)(2)(B), in any election year (i.e., even-numbered years), monthly reports are due not later than the 20th day after the end of the month (see Q&A-30), except the organization shall not file the reports regularly due in November and December (i.e., the monthly reports for activity in October and November). Instead, the organization must file a Form 8872 report not later than 12 days before the general election (or 15 days before the general election if posted by registered or certified mail) that contains information through the 20th day before the general election. The organization must also file a report no more than 30 days after the general election which shall contain information through the 20th day after the election. The December activity is included in the year-end report due not later than January 31 of the following year.

32. Q. If an organization chooses not to file on a monthly basis, when is Form 8872 due in a non-election year?

A. Pursuant to § 527(j)(2)(A), a political organization that chooses not to file monthly must file semi-annual reports in non-election years (i.e., odd-numbered years). These reports are due not later than July 31 for the first half of the year and, for the second half of the year, not later than January 31 of the following year.

33. Q. If an organization chooses not to file on a monthly basis, when is Form 8872 due during an election year?

A. Pursuant to § 527(j)(2)(A), in an election year (even-numbered years), an organization that chooses not to file monthly reports must file quarterly reports not later than the 15th day after the last day of the quarter, except that the return for the final quarter shall be due not later than January 31 of the following year. The organization must also file a post-general election report not later than 30 days after the general election that contains information through the 20th day after the election. In addition, the organization must file a pre-election report for any election for federal office with respect to which the organization makes a contribution or expenditure. These reports shall be filed not later than 12 days before the election (15 days before if posted by registered or certified mail) and must contain information through the 20th day before the election.

34. Q. What is an election for purposes of the reporting deadlines under § 527(j)?

A. For purposes of determining what is an election year and what elections trigger the pre-election and post-general election reports, § 527(j)(6) provides that an "election" is a general, special, primary, or runoff election for a federal office; a convention or caucus of a political party with authority to nominate a candidate for federal office; a primary election to select delegates to a national nominating convention of a political party; or a primary election to express a preference for the nomination of individuals for election to the office of President. Thus, an election for purpose

of these reporting deadlines does not include a purely state or local election. When an election involves both candidates for federal office and candidates for state or local offices, it is an election for purposes of the reporting deadlines, but only those organizations that make contributions or expenditures with respect to the candidates for federal office are required to file the pre-election reports for those elections under § 527(j)(2)(A)(i)(II). However, all reports filed under § 527(j) must contain information about the contributions and expenditures within the reporting period, regardless of whether they were accepted or made with respect to candidates for federal, state or local office.

35. Q. What is a general election?

A. A general election is either one of the following:

(a) an election for federal office held in even numbered years on the Tuesday following the first Monday in November or

(b) an election held to fill a vacancy in a federal office (i.e., a special election) that is intended to result in the final selection of a single individual to the office at stake. See 11 C.F.R. 100.2(b).

36. Q. How will "election" under § 527(j)(6) be interpreted?

A. The definition of "election" under § 527(j)(6) is virtually identical to the definition of "election" under FECA (2 U.S.C. § 431(1)). Organizations may rely on FEC interpretations of the FECA definition in the absence of further guidance from the Service. The FEC publishes information concerning the filing requirements under FECA and the dates for filing those reports, including information on the dates of elections, on its Web Site at http://www.fec.gov/pages/report.htm.

37. Q. What must a Form 8872 report contain?

A. The report must include the name, address, and (if an individual) the occupation and employer, of any person to whom expenditures are made that aggregate $500 or more in a calendar year and the amount of such expenditure. The report must also include the name, address, and (if an individual) the occupation and employer, of any person that contributes in the aggregate $200 or more in a calendar year and the amount of such contribution. However, an organization is not required to report independent expenditures, as defined in § 301 of FECA. Only expenditures made or contributions received after July 1, 2000, that are not made or received pursuant to binding contracts entered into before July 2, 2000, must be reported.

38. Q. What is an independent expenditure under § 301 of FECA?

A. An independent expenditure is an expenditure by a person expressly advocating the election or defeat of a clearly identified candidate for federal office which is made without cooperation or consultation with any candidate for federal office, or any authorized committee or agent of such candidate, and which is not made in concert with, or at the request or suggestion of, any candidate for federal office, or authorized committee or agent of such candidate. See 2 U.S.C. § 431(17).

39. Q. Where is the Form 8872 filed?

A. The report is filed by sending a signed copy of Form 8872 to the Internal Revenue Service Center, Ogden, UT 84201. The form must be signed by an official authorized by the organization to sign the report.

40. Q. What if a political organization that has filed Form 8871 does not file the required Form 8872?

A. Under § 527(j)(1), a political organization that does not file the required Form 8872 or which fails to include the information required on the Form 8872 is subject to a penalty equal to the amount of contributions and expenditures that are not disclosed multiplied by the highest corporate tax rate, currently 35 percent.

41. Q. Is the Form 8872 filed by political organizations publicly available?

A. Yes. Under § 6104(b) and § 6104(d)(6), Form 8872 will be made available for public inspection by the Service. Copies of Form 8872 that have been filed are currently available at the IRS Web Site at www.irs.gov/polorgs and are considered widely available under § 301.6104(d)-3, as long as the organization provides the IRS Web Site address to the person making the request. In addition, under § 6104(d)(1)(A), the organization is required to make a copy of these reports available for public inspection during regular business hours at the organization's principal office (and at each of its regional or district offices having at least three paid employees) in the same manner as applications for exemption of § 501(c) organizations are made available. Pursuant to § 6104(b) and § 6104(d)(3)(A), contributor information must be disclosed to the public.

42. Q. What if the political organization does not make its Form 8872 publicly available?

A. Under § 6652(c)(1)(C), a penalty of $20 per day may be imposed on any person with a duty to comply with the public inspection requirement for each day a failure to comply continues. The maximum penalty that may be incurred for any failure to disclose any one report is $10,000.

III. Annual Return Requirements

43. Q. Which political organizations are required to file annual income tax returns?

A. A political organization that has taxable income in excess of the $100 specific deduction allowed under § 527 is required to file an annual income tax return on Form 1120-POL, *U.S. Income Tax Return for Certain Political Organizations*. In addition, for taxable years beginning after June 30, 2000, a political organization that has $25,000 or more in gross receipts for the taxable year is also required to file Form 1120-POL, without regard to whether it has taxable income. § 6012(a)(6).

44. Q. When is the Form 1120-POL due?

A. The Form 1120-POL is due on or before the 15th day of the third month after the close of the organization's taxable year. § 6072(b). Thus, for a calendar-year taxpayer, Form 1120-POL is due on March 15 of the following year.

45. Q. Which political organizations are required to file an annual information return?

A. A political organization that is required under § 6012(a)(6) to file an income tax return is also required to file Form 990, *Return of Organization Exempt from Income Tax,* for taxable

years beginning after June 30, 2000. § 6033(g). Organizations with gross receipts less than $100,000 and assets less than $250,000 may file Form 990-EZ, *Short Form Return of Organization Exempt from Income Tax*. Organizations with gross receipts of less than $25,000 are not required to file Form 990 or Form 990-EZ.

46. Q. When is the Form 990 due?

A. The Form 990 (or Form 990-EZ) is due on or before the 15th day of the fifth month after the close of the organization's taxable year. Thus, for a calendar-year taxpayer, Form 990 is due on May 15 of the following year.

47. Q. What if the political organization fails to file Form 1120-POL or Form 990?

A. A political organization that fails to file a required Form 1120-POL or Form 900 or fails to include required information on those returns is subject to a penalty of $20 per day for every day such failure continues. The maximum penalty imposed regarding any one return is the lesser of $10,000 or 5 percent of the gross receipts of the organization for the year. In the case of an organization having gross receipts exceeding $1,000,000 for any year, the penalty is increased to $100 per day with a maximum penalty of $50,000. § 6652(c)(1)(A).

48. Q. Are the Forms 1120-POL and Forms 990 filed by political organizations publicly available?

A. Yes, the Forms 1120-POL and the Forms 990 filed for taxable years beginning after June 30, 2000 will be made available for public inspection by the Service. § 6104(b). In addition, each political organization must make a copy of its returns available for public inspection during regular business hours at its principal office (and any regional or district offices having at least three paid employees) in the same manner as annual information returns of § 501(c) organizations are made available. It must also provide a copy of the returns to any person requesting a copy in person or in writing without charge other than a reasonable charge for reproduction and postage in the same manner that § 501(c) organizations provide copies of their annual returns. § 6104(d)(1). If an organization's returns are widely available under § 301.6104(d)-3 (such as on the Internet), the organization need not respond to requests for copies so long as it provides the web site address where the returns are available to the person making the request. Returns only need to be made available for three years after filing. § 6104(d)(2). Contributor information must be disclosed to the public. § 6104(d)(3)(A).

49. Q. What if the political organization does not make its Forms 1120-POL and Forms 990 publicly available?

A. A penalty of $20 per day may be imposed on any person with a duty to comply with the public inspection requirement for each day a failure to comply continues. The maximum penalty that may be incurred for any failure to disclose any one return is $10,000. § 6652(c)(1)(C).

IV. General

50. Q. What if the filing date for any of these forms falls on Saturday, Sunday or a holiday?

A. If any due date falls on a Saturday, Sunday or legal holiday, the organization may file the report on the next business day.

51. Q. Where can organizations get copies of the various forms?

A. The various forms (Form SS-4, Form 8871, Form 8872, Form 1120-POL, and Form 990) and their instructions are available by calling 1-800-TAX-Form (1-800-829-3676) or via the Internet at the IRS Web Site at www.irs.gov in the "Forms and Publications" section.

52. Q. What if an organization has questions regarding the notice and reporting requirements or has any problem obtaining an EIN?

A. For more information or if an organization has any problem obtaining an EIN, organizations may call the TE/GE Customer Service Center at 1-877-829-5500.

DRAFTING INFORMATION

The principal author of this announcement is Judith E. Kindell of Exempt Organizations. For further information regarding this announcement contact Judith E. Kindell on (202) 622-6494 (not a toll-free call).

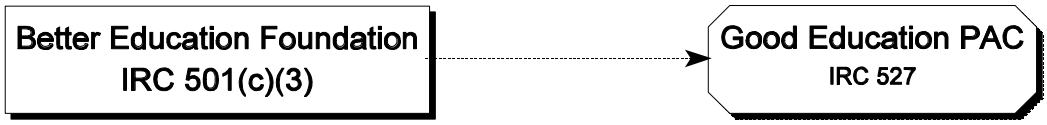
## APPENDIX IV

### Political Campaign Activity and Affiliations Between and Among Exempt Organizations

1. May an IRC 501(c) contribute to a PAC?

Better Education Foundation is an IRC 501(c)(3) organization whose charitable purpose is to improve education. Good Education PAC is an IRC 527 organization that promotes candidates for public office that support good education. Better Education Foundation makes a contribution to Good Education PAC, as illustrated in Example 1.

**Example 1**

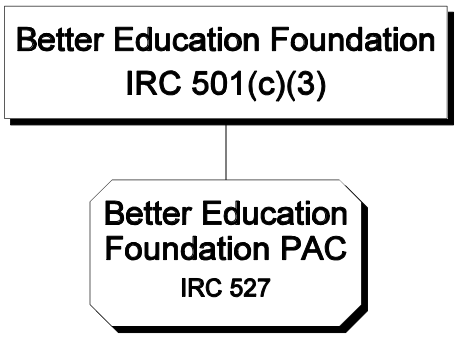



Better Education Foundation has violated the political campaign prohibition. It may not do indirectly what it could not do directly.

2. May an IRC 501(c)(3) establish an IRC 527 PAC?

Better Education Foundation is exempt under IRC 501(c)(3). It establishes a PAC under federal election laws, the Better Education Foundation PAC. See Example 2, below.

**Example 2**

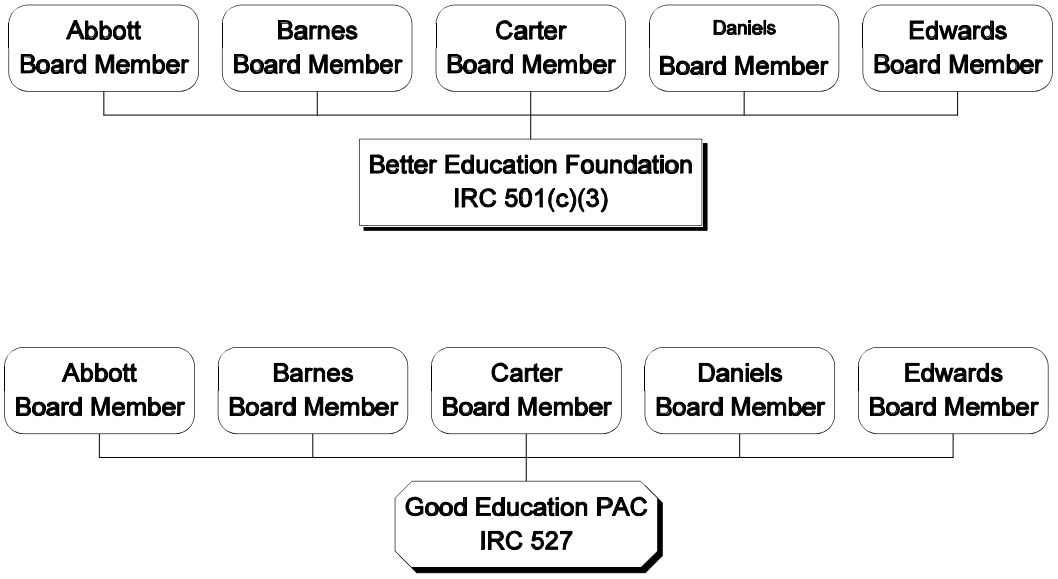



The Better Education Foundation has violated the prohibition on participation or intervention in a political campaign on behalf of or in opposition to any candidate for public office. As discussed above, the legislative history of IRC 527 makes it clear it was not intended to affect in any way the prohibition against participation or intervention in a political campaign by IRC 501(c)(3) organizations. This is true whether the PAC is a federal PAC or a state PAC. It is true even if the PAC ultimately repays any funds used for establishing the organization. The IRC 501(c)(3) organization may not do indirectly through a PAC what it could not do directly itself.

3. May the directors of an IRC 501(c)(3) organization establish a PAC?

Abbott, Barnes, Carter, Daniels and Edwards are members of the Board of Directors of Better Education Foundation, an IRC 501(c)(3) organization. Because of their interest in education, Abbott, Barnes, Carter, Daniels and Edwards decide to establish the Good Education PAC. They do so on their own time and without using any of the resources or facilities of Better Education Foundation. See Example 3, below.

**Example 3**

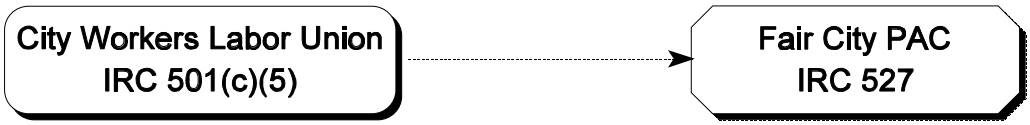



Better Education Foundation has not violated the political campaign intervention prohibition. The members of the Board of Directors are not prohibited from engaging in political activity simply because they are on the Board of an IRC 501(c)(3) organization.

4. May an IRC 501(c) organization other than an IRC 501(c)(3) organization contribute to an IRC 527 PAC?

City Workers Labor Union is an IRC 501(c)(5) organization that represents city workers. Fair City PAC is an IRC 527 organization that promotes candidates who support higher wages for city employees. City Workers Labor Union makes a contribution to Fair City PAC as illustrated below, in Example 4.

**Example 4**

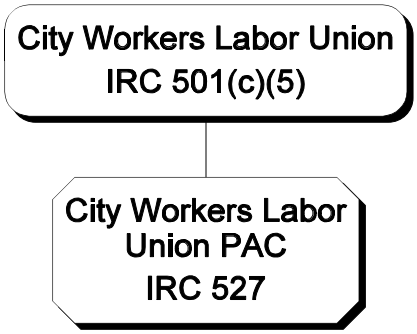



So long as political campaign intervention is not the primary activity of City Workers Labor Union, it will not jeopardize the exempt status under IRC 501(c)(5) of City Workers Labor Union. However, City Workers Labor Union will be subject to tax on the lesser of the contribution or its investment income under IRC 527(f). The result would be the same for IRC 501(c)(4) social welfare organizations and IRC 501(c)(6) trade associations.

5. May an IRC 501(c) organization other than an IRC 501(c)(3) organization establish an IRC 527 PAC?

The City Workers Labor Union is an IRC 501(c)(5) organization. It establishes an IRC 527 PAC, the City Workers Labor Union PAC. See Example 5, below.

**Example 5**



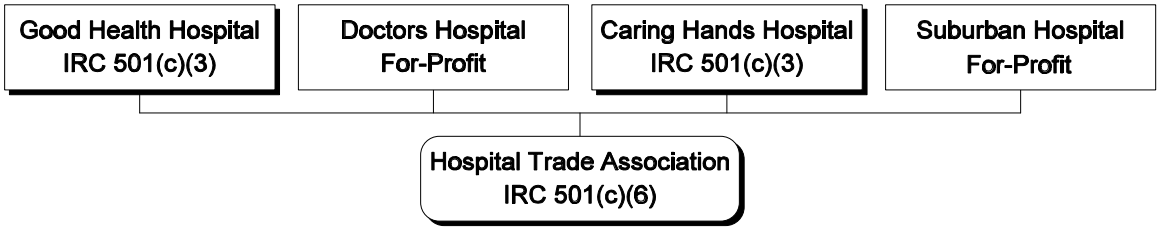

The provisions of IRC 527(f) encourage IRC 501(c) organizations that are not prohibited from intervening or participating in political campaigns, such as IRC 501(c)(4), IRC 501(c)(5) and IRC 501(c)(6) organizations, to establish separate PACs to engage in their political campaign activities.

6. May an IRC 501(c)(3) organization be a member of an IRC 501(c) organization that engages in some political activity?

Good Health Hospital and Caring Hands Hospital are both exempt as IRC 501(c)(3) organizations. Doctors Hospital and Suburban Hospital are for-profit hospitals. All four hospitals are located in Fair City. Hospital Trade Association is an IRC 501(c)(6) organization that promotes the hospital industry in Fair City. All four hospitals are members of Hospital Trade Association, as

illustrated below, in Example 6. Hospital Trade Association does engage in some political campaign activity, but it is not its primary activity.

**Example 6**

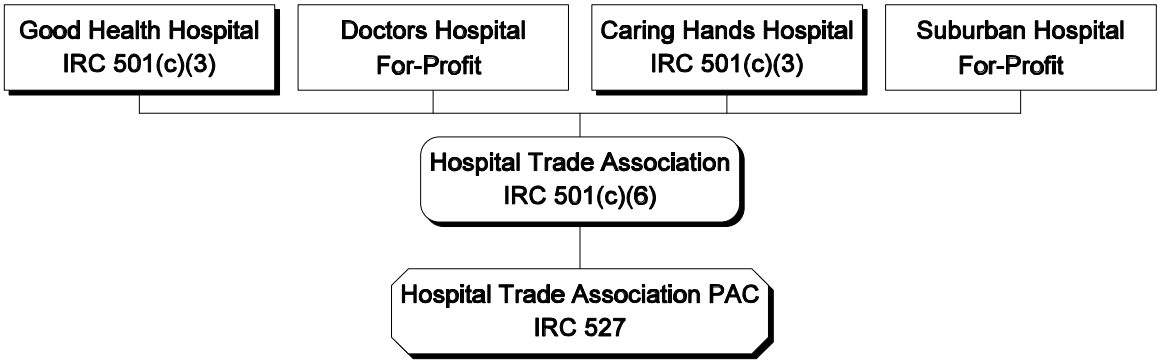



Good Health Hospital and Caring Hands Hospital may be members of Hospital Trade Association without jeopardizing their exempt status provided they do not earmark any of their contributions for the political campaign activity of Hospital Trade Association.

7. May an IRC 501(c) organization that has IRC 501(c)(3) members establish an IRC 527 organization?

Good Health Hospital and Caring Hands Hospital are both exempt as IRC 501(c)(3) organizations. Doctors Hospital and Suburban Hospital are for-profit hospitals. All four hospitals are located in Fair City. Hospital Trade Association is an IRC 501(c)(6) organization that promotes the hospital industry in Fair City. All four hospitals are members of Hospital Trade Association. Hospital Trade Association establishes Hospital Trade Association PAC, an IRC 527 organization. See Example 7, below.

**Example 7**

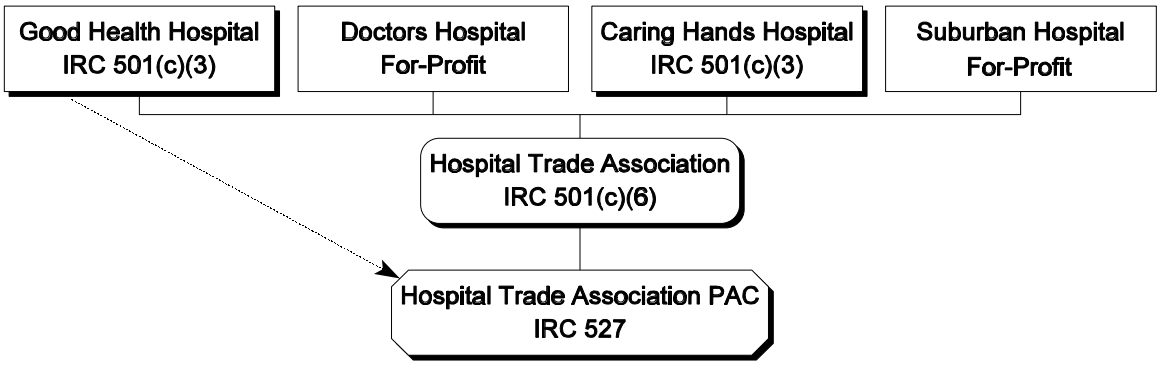



Whether Hospital Trade Association carries on its activities directly or through an IRC 527 organization, Good Health Hospital and Caring Hands Hospital may be members of Hospital Trade Association without jeopardizing their exempt status provided they do not earmark any of their contributions for the political campaign activity of Hospital Trade Association.

8. May an IRC 501(c)(3) organization contribute to an IRC 527 organization that is affiliated with an IRC 501(c) organization of which the IRC 501(c)(3) organization is a member?

Good Health Hospital and Caring Hands Hospital are both exempt as IRC 501(c)(3) organizations. Doctors Hospital and Suburban Hospital are for-profit hospitals. All four hospitals are located in Fair City. Hospital Trade Association is an IRC 501(c)(6) organization that promotes the hospital industry in Fair City. All four hospitals are members of Hospital Trade Association. Hospital Trade Association establishes Hospital Trade Association PAC, an IRC 527 organization. Good Health Hospital contributes a portion of its Hospital Trade Association Dues to the Hospital Trade Association PAC through a checkoff program, as illustrated in Example 8, below.

**Example 8**

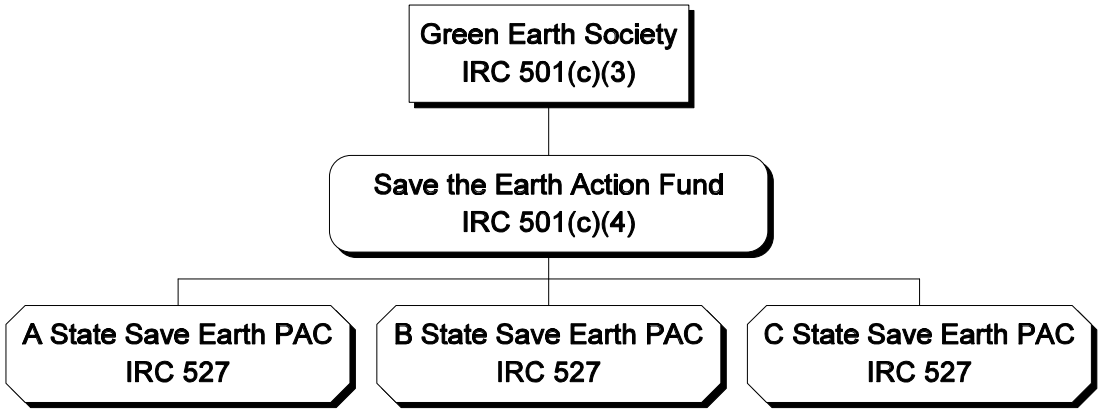



Good Health Hospital has violated the prohibition on participation or intervention in a political campaign on behalf of or in opposition to any candidate for public office by contributing to the Hospital Trade Association PAC through the checkoff program.

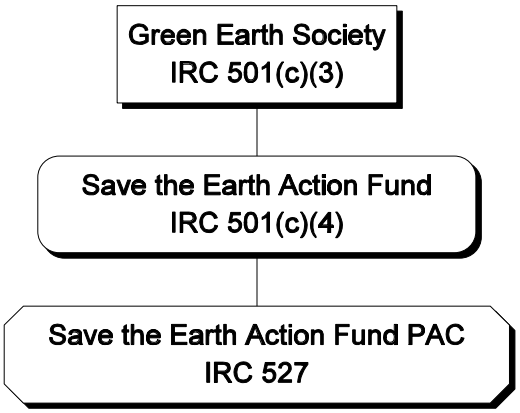
9. May an IRC 501(c)(3) organization establish an IRC 501(c) organization that establishes an IRC 527 PAC?

Green Earth Society is an IRC 501(c)(3) organization. It establishes an IRC 501(c)(4) organization, Save the Earth Action Fund, to engage in substantial lobbying activities. Save the Earth Action Fund establishes several PACs under the election laws of various states, as illustrated in Example 9, below. Save the Earth Action Fund also establishes a federal PAC, Save the Earth Action Fund PAC, an IRC 527 organization. See Example 10 below. Green Earth Society and Save the Earth Action Fund do not commingle their finances or other resources, conduct separate activities in furtherance of their exempt purposes and maintain and respect their separate entities. Green Earth Society does not earmark for political campaign activities any support it provides to Save the Earth Action Fund.

**Example 9**




**Example 10**

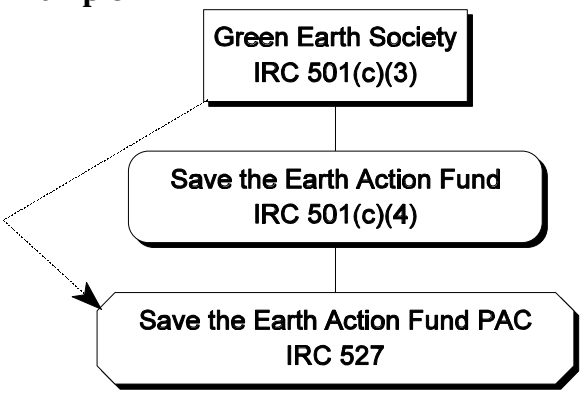



The mere establishment and affiliation of these federal and state IRC 527 organizations by Save the Earth Action Fund does not result in Green Earth Society having violated the political campaign prohibition. So long as the organizations themselves act as separate entities and not as agents of the other, the Service will respect the separate legal status of the organizations and not attribute activities of the IRC 501(c) organization to the IRC 501(c)(3).

10. May an IRC 501(c)(3) organization that establishes an IRC 501(c) organization contribute to an IRC 527 organization established by the IRC 501(c) organization?

Green Earth Society is an IRC 501(c)(3) organization that has established an IRC 501(c)(4) organization, Save the Earth Action Fund. Save the Earth Action Fund establishes Save the Earth Action Fund PAC, an IRC 527 organization. Green Earth Society contributes to the Save the Earth Action Fund PAC, as illustrated in Example 11, below.

**Example 11**

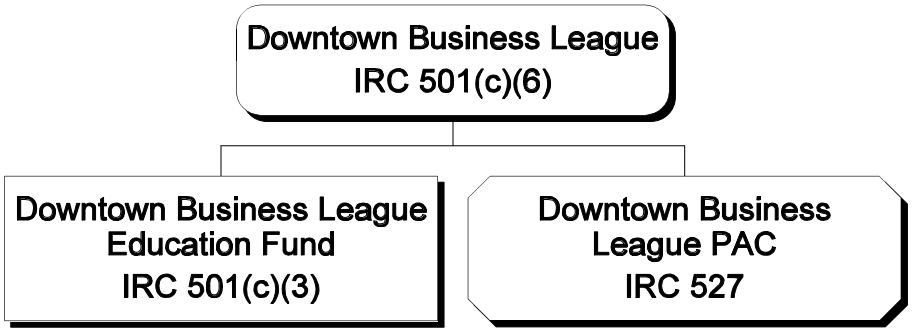



Green Earth Society has violated the prohibition on political campaign activity by contributing to the Save the Earth Action Fund PAC.

11. May an IRC 501(c) organization establish both an IRC 501(c)(3) organization and an IRC 527 organization?

Downtown Business League is an IRC 501(c)(6) organization that promotes businesses in the downtown area. It establishes Downtown Business League Education Fund to carry on educational activities. It also establishes Downtown Business League PAC to support candidates who promote downtown business development. See Example 12, below.

**Example 12**

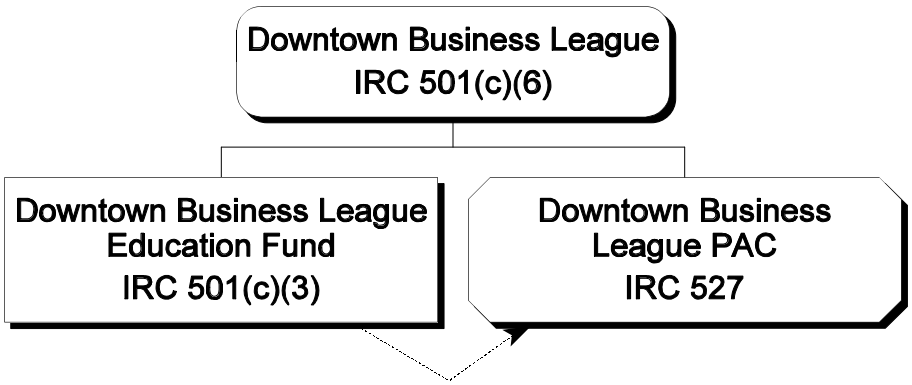



Downtown Business League Education Fund has not violated the political campaign prohibition merely because it was established by Downtown Business League, which also established Downtown Business League PAC. As long as the three organizations maintain their separate existence, the activities of one will not be attributed to the others. The result would be the same for IRC 501(c)(4) social welfare organizations and IRC 501(c)(5) labor unions.

12. May an IRC 501(c)(3) organization that was established by an IRC 501(c) organization contribute to an IRC 527 organization also established by the IRC 501(c) organization?

Downtown Business League is an IRC 501(c)(6) organization that promotes businesses in the downtown area. It establishes Downtown Business League Education Fund to carry on educational activities. It also establishes Downtown Business League PAC to support candidates who promote downtown business development. Downtown Business League Education Fund makes a contribution to Downtown Business League PAC as illustrated below in Example 13.

**Example 13**




Downtown Business League has violated the prohibition on participating or intervening in a political campaign on behalf of or in opposition to a candidate for public office.

## *Subject Listing*